

TAB 188

In The Matter Of:

*AHERF v.
PRICEWATERHOUSECOOPERS, LLP.*

DOROTHY MCKENNA BROWN, ED.D.

May 4, 2004

LEGALINK MANHATTAN
420 Lexington Avenue - Suite 2108
New York, NY 10170
PH: 212-557-7400 / FAX: 212-692-9171

BROWN, ED.D., DOROTHY MCKENNA



<p style="text-align: right;">Page 33</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. Management, yes.</p> <p>3 Q. And did they refer to -- management refer to</p> <p>4 this as an integrated delivery system or IDS?</p> <p>5 A. I don't -- I'm not sure that I heard them say</p> <p>6 that, but I would think that was the intention.</p> <p>7 Q. And who in particular -- do you know whose</p> <p>8 idea it was to develop AHERF into an integrated</p> <p>9 system?</p> <p>10 MR. McCLENAHAN: Object to form.</p> <p>11 MS. MEADEN: Objection.</p> <p>12 A. I don't know whose idea it was, but Sheriff</p> <p>13 articulated the vision.</p> <p>14 Q. And did the board of trustees agree with Mr.</p> <p>15 Abdelhak's articulation of the need to develop an</p> <p>16 integrated system for AHERF?</p> <p>17 MS. MEADEN: Objection.</p> <p>18 A. We agreed with his vision.</p> <p>19 Q. Do you remember any trustees -- just any</p> <p>20 particular trustees voicing disagreement with the</p> <p>21 vision, saying we should go another way instead?</p> <p>22 A. No.</p> <p>23 Q. Were there trustees who put questions to Mr.</p> <p>24 Abdelhak about the vision that you recall?</p> <p>25 MS. MEADEN: Objection. Foundation.</p>	<p style="text-align: right;">Page 35</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 Q. Do you remember which newspaper you read</p> <p>3 about that?</p> <p>4 A. The Inquirer, Philadelphia Inquirer.</p> <p>5 Q. That's the major daily newspaper here in</p> <p>6 Philadelphia?</p> <p>7 A. Yes.</p> <p>8 Q. What was your -- well, do you remember</p> <p>9 reading the article at home or in your office?</p> <p>10 A. At home.</p> <p>11 Q. And does the paper come out in the mornings?</p> <p>12 A. Yes.</p> <p>13 Q. And do you recall what the article said?</p> <p>14 A. That Allegheny was -- I forget the word, and</p> <p>15 it's probably -- it's an important distinction, but</p> <p>16 that they were acquiring, I guess is the word, the</p> <p>17 Graduate Health System.</p> <p>18 Q. Let me show you a document that has</p> <p>19 previously been marked as Exhibit 579.</p> <p>20 MR. McCLENAHAN: Take a minute to read</p> <p>21 it.</p> <p>22 Q. Yes, please read this entire article. I will</p> <p>23 tell you that Exhibit 579 is a copy of an article</p> <p>24 that was printed off the Web site for the</p> <p>25 Philadelphia Inquirer. It was an article that</p>
<p style="text-align: right;">Page 34</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. Well, the vision was in place before</p> <p>3 Hahnemann merged, so when I arrived on the board,</p> <p>4 they were playing out the vision I guess.</p> <p>5 Q. Hahnemann acquisition was part of the vision?</p> <p>6 A. Was part of the vision and so, you know, each</p> <p>7 step along the way trustees would ask questions</p> <p>8 and -- but there was no antagonism or great</p> <p>9 disagreement with him.</p> <p>10 Q. For subsequent acquisitions when you were on</p> <p>11 the board after the Hahnemann acquisition, would Mr.</p> <p>12 Abdelhak explain or present reasons why this</p> <p>13 acquisition would make sense for AHERF and then they</p> <p>14 would be approved by the board?</p> <p>15 A. Usually.</p> <p>16 Q. Are there any instances that come to mind</p> <p>17 where that didn't happen?</p> <p>18 A. Yes.</p> <p>19 Q. And what was that or those?</p> <p>20 A. Well, the Graduate Hospital acquisition. We</p> <p>21 read about it in the papers. And when I called Mr.</p> <p>22 Abdelhak, he said that it had been approved by the</p> <p>23 executive committee, and a number of us complained</p> <p>24 about such a large undertaking not being vetted with</p> <p>25 the whole board before it was done.</p>	<p style="text-align: right;">Page 36</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 appeared on Page D-1 of the Philadelphia Inquirer on</p> <p>3 August 11, 1996. This isn't the actual photocopy</p> <p>4 from the newspaper, but when you go onto the Web</p> <p>5 site, you can print the stories that were in the</p> <p>6 newspaper. And I'll just give you time to read</p> <p>7 this.</p> <p>8 MS. MEADEN: Jeff, do you know whose</p> <p>9 underlinings these are?</p> <p>10 MR. FRIESEN: I don't know whose</p> <p>11 underlinings they are. I know they're not mine.</p> <p>12 Q. Oh, and, by the way, the headline of the</p> <p>13 newspaper is "Absorbing Graduate Health Entails</p> <p>14 Risk."</p> <p>15 Do you think that this is the article --</p> <p>16 A. Yes.</p> <p>17 Q. -- that you were referring to?</p> <p>18 And it looks like this was on the first</p> <p>19 page of the business section?</p> <p>20 MS. MEADEN: Objection.</p> <p>21 MR. McCLENAHAN: Yeah, I mean --</p> <p>22 A. Somewhere in there.</p> <p>23 MR. McCLENAHAN: -- is that a question?</p> <p>24 Q. Now, had you never heard of AHERF potentially</p> <p>25 acquiring the Graduate Hospital System until you</p>
<p style="text-align: right;">Page 33</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. Management, yes.</p> <p>3 Q. And did they refer to -- management refer to</p> <p>4 this as an integrated delivery system or IDS?</p> <p>5 A. I don't -- I'm not sure that I heard them say</p> <p>6 that, but I would think that was the intention.</p> <p>7 Q. And who in particular -- do you know whose</p> <p>8 idea it was to develop AHERF into an integrated</p> <p>9 system?</p> <p>10 MR. McCLENAHAN: Object to form.</p> <p>11 MS. MEADEN: Objection.</p> <p>12 A. I don't know whose idea it was, but Sheriff</p> <p>13 articulated the vision.</p> <p>14 Q. And did the board of trustees agree with Mr.</p> <p>15 Abdelhak's articulation of the need to develop an</p> <p>16 integrated system for AHERF?</p> <p>17 MS. MEADEN: Objection.</p> <p>18 A. We agreed with his vision.</p> <p>19 Q. Do you remember any trustees -- just any</p> <p>20 particular trustees voicing disagreement with the</p> <p>21 vision, saying we should go another way instead?</p> <p>22 A. No.</p> <p>23 Q. Were there trustees who put questions to Mr.</p> <p>24 Abdelhak about the vision that you recall?</p> <p>25 MS. MEADEN: Objection. Foundation.</p>	<p style="text-align: right;">Page 35</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 Q. Do you remember which newspaper you read</p> <p>3 about that?</p> <p>4 A. The Inquirer, Philadelphia Inquirer.</p> <p>5 Q. That's the major daily newspaper here in</p> <p>6 Philadelphia?</p> <p>7 A. Yes.</p> <p>8 Q. What was your -- well, do you remember</p> <p>9 reading the article at home or in your office?</p> <p>10 A. At home.</p> <p>11 Q. And does the paper come out in the mornings?</p> <p>12 A. Yes.</p> <p>13 Q. And do you recall what the article said?</p> <p>14 A. That Allegheny was -- I forget the word, and</p> <p>15 it's probably -- it's an important distinction, but</p> <p>16 that they were acquiring, I guess is the word, the</p> <p>17 Graduate Health System.</p> <p>18 Q. Let me show you a document that has</p> <p>19 previously been marked as Exhibit 579.</p> <p>20 MR. McCLENAHAN: Take a minute to read</p> <p>21 it.</p> <p>22 Q. Yes, please read this entire article. I will</p> <p>23 tell you that Exhibit 579 is a copy of an article</p> <p>24 that was printed off the Web site for the</p> <p>25 Philadelphia Inquirer. It was an article that</p>
<p style="text-align: right;">Page 34</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. Well, the vision was in place before</p> <p>3 Hahnemann merged, so when I arrived on the board,</p> <p>4 they were playing out the vision I guess.</p> <p>5 Q. Hahnemann acquisition was part of the vision?</p> <p>6 A. Was part of the vision and so, you know, each</p> <p>7 step along the way trustees would ask questions</p> <p>8 and -- but there was no antagonism or great</p> <p>9 disagreement with him.</p> <p>10 Q. For subsequent acquisitions when you were on</p> <p>11 the board after the Hahnemann acquisition, would Mr.</p> <p>12 Abdelhak explain or present reasons why this</p> <p>13 acquisition would make sense for AHERF and then they</p> <p>14 would be approved by the board?</p> <p>15 A. Usually.</p> <p>16 Q. Are there any instances that come to mind</p> <p>17 where that didn't happen?</p> <p>18 A. Yes.</p> <p>19 Q. And what was that or those?</p> <p>20 A. Well, the Graduate Hospital acquisition. We</p> <p>21 read about it in the papers. And when I called Mr.</p> <p>22 Abdelhak, he said that it had been approved by the</p> <p>23 executive committee, and a number of us complained</p> <p>24 about such a large undertaking not being vetted with</p> <p>25 the whole board before it was done.</p>	<p style="text-align: right;">Page 36</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 appeared on Page D-1 of the Philadelphia Inquirer on</p> <p>3 August 11, 1996. This isn't the actual photocopy</p> <p>4 from the newspaper, but when you go onto the Web</p> <p>5 site, you can print the stories that were in the</p> <p>6 newspaper. And I'll just give you time to read</p> <p>7 this.</p> <p>8 MS. MEADEN: Jeff, do you know whose</p> <p>9 underlinings these are?</p> <p>10 MR. FRIESEN: I don't know whose</p> <p>11 underlinings they are. I know they're not mine.</p> <p>12 Q. Oh, and, by the way, the headline of the</p> <p>13 newspaper is "Absorbing Graduate Health Entails</p> <p>14 Risk."</p> <p>15 Do you think that this is the article --</p> <p>16 A. Yes.</p> <p>17 Q. -- that you were referring to?</p> <p>18 And it looks like this was on the first</p> <p>19 page of the business section?</p> <p>20 MS. MEADEN: Objection.</p> <p>21 MR. McCLENAHAN: Yeah, I mean --</p> <p>22 A. Somewhere in there.</p> <p>23 MR. McCLENAHAN: -- is that a question?</p> <p>24 Q. Now, had you never heard of AHERF potentially</p> <p>25 acquiring the Graduate Hospital System until you</p>

Page 37

1 Dorothy McKenna Brown, Ed.D.
 2 read this article?

3 A. Correct.

4 MS. MEADEN: Objection as to form.

5 Q. And down near the bottom it says "Allegheny
 6 spokesman Tom Chakurda said this was expected to
 7 last about a year before consolidation is complete."

8 Did you know who Mr. Chakurda was?

9 MR. McCLENAHAN: That is referring to
 10 the paragraph immediately above it.

11 MR. FRIESEN: Yes. Let me back up.

12 Q. It says, "For now, Allegheny has agreed only
 13 to manage the hospitals for an undisclosed fee
 14 without taking full financial control or
 15 responsibility for debt. Allegheny spokesman Tom
 16 Chakurda said this was expected to last about a year
 17 before consolidation is complete."

18 Did you know who Mr. Chakurda was?

19 A. I think he was the PR person.

20 Q. Do you see the first paragraph says, "The
 21 Allegheny Health Education and Research Foundation
 22 is about to take on a high-risk case in the Graduate
 23 Health System according to the diagnosis of local
 24 healthcare analysts"?

25 A. (Witness shakes head in the affirmative.)

Page 39

1 Dorothy McKenna Brown, Ed.D.
 2 boards are for comment in that kind of a situation I
 3 think.

4 He told me that he had the approval of
 5 the executive committee and he got quite annoyed and
 6 hung up.

7 Q. He hung up on you?

8 A. He hung up on me, called the next morning at
 9 5 o'clock to apologize.

10 And then we had a subsequent meeting,
 11 and I'm sure you have the minutes and whatever where
 12 he outlined the deal and how it would be handled and
 13 it would not jeopardize the AHERF financial
 14 stricture.

15 And the one thing that this doesn't say
 16 but I think was said somewhere in a meeting, that
 17 also coming with it would have been the money from
 18 the Graduate Foundation, which I think was close to
 19 a hundred million dollars, and it never did.

20 Q. It never did come?

21 A. It never did come, and I don't know that it
 22 was part of the official deal, but I just have a
 23 recollection of that in a conversation.

24 MS. MEADEN: I'm sorry. I don't mean to
 25 interrupt, but just to clarify, a recollection that

Page 38

1 Dorothy McKenna Brown, Ed.D.

2 Q. Can you remember any reaction that you had
 3 when you read that?

4 MS. MEADEN: Objection.

5 A. Should I answer?

6 MS. MEADEN: Go ahead.

7 Q. Oh, yes.

8 MR. McCLENAHAN: The question is do you
 9 remember your reaction.

10 A. Yes, I do remember my reaction. As a
 11 trustee, I didn't enjoy reading about a major change
 12 in the newspaper, not knowing one thing about it,
 13 and I called a variety of people -- I can't tell you
 14 in what order, but the Philadelphia trustees, some
 15 of them, Leslie Miller who was then chair of the
 16 academic affairs committee, Claire Gargalli, Leon
 17 Sunstein, Bob Palmer, Al Martinelli; and we had sort
 18 of a back-and-forth conversation in different ways
 19 about it.

20 I called Sherif and I asked him why he
 21 had a board if he was going to have this kind of
 22 activity without consulting with the full board, not
 23 that I had a particular problem at that point with
 24 the acquisition because it seemed to fit, as this
 25 article goes on to relate, in with the vision, but

Page 40

1 Dorothy McKenna Brown, Ed.D.

2 someone had told you that that money was going to
 3 come --

4 THE WITNESS: That that foundation would
 5 also come with...

6 Q. Okay. Let me try and unpack a few of these.
 7 The conversations with Miss Miller, Miss
 8 Gargalli, Mr. Sunstein, Mr. Palmer and
 9 Mr. Martinelli, these were all separate
 10 conversations?

11 A. Yes.

12 Q. There were no conference calls with more than
 13 one of them on the line?

14 A. No.

15 And some of them wrote letters to
 16 Sherif. I didn't. I called him. Some of them
 17 called and wrote letters.

18 Q. And you called each of those people: Miller,
 19 Gargalli, Sunstein, Palmer and Martinelli, before
 20 you called Sherif?

21 MR. McCLENAHAN: If you know.

22 A. I don't remember. I probably called one or
 23 two to say -- you know, because I thought was I
 24 asleep at the switch or at some meeting and I didn't
 25 hear this, and, you know, I can't tell you in what

Page 41

1 Dorothy McKenna Brown, Ed.D.
 2 order I called, but none of those people had any
 3 knowledge of it.
 4 Q. Let me just plumb your memory for a moment on
 5 each of these conversations. Maybe you don't
 6 remember anything about them, but maybe you do.
 7 Let's start with Leslie Ann Miller. Do
 8 you remember any of the details of that
 9 conversation?
 10 A. No. As I remember it now -- I don't know how
 11 many years we are going back -- they were pretty
 12 much the same. There was just a general concern
 13 that things of major importance were being
 14 undertaken without discussing it with the full
 15 board.
 16 Q. And each of those people had that --
 17 A. They had that same feeling.
 18 Q. -- agreed with you?
 19 A. You know, we didn't say, oh, it is going to
 20 lose this much money or we are going to have to
 21 spend or anything like that; it was really with
 22 where the board fit in all of this activity.
 23 Q. Can you remember anything specifically about
 24 your conversation with Miss Gargalli other than what
 25 you have already said?

Page 43

1 Dorothy McKenna Brown, Ed.D.
 2 A. The conversation and whatever had taken
 3 place, and, you know, couldn't take it back.
 4 Q. I see. His interview with the press --
 5 A. Or whoever.
 6 Q. -- Mr. Jacordis?
 7 A. The other thing that I have learned is that
 8 when these things are reported, when anything is
 9 reported, it's probably half true and half wishful
 10 thinking, so, you know, how far along were they
 11 really compared to what this article says, that's
 12 questionable.
 13 Q. I take it people don't hang up on you very
 14 often?
 15 A. I never had anyone hang up on me before
 16 except my mother.
 17 MR. McCLENAHAN: That's allowed.
 18 Q. Do you remember where you were in the
 19 conversation when he hung up on you?
 20 A. I said to him, "I don't know why you have a
 21 board if you are going to operate like this," and
 22 that's when he hung up.
 23 Q. Now, the next morning when he called to
 24 apologize, what do you remember about that
 25 conversation?

Page 42

1 Dorothy McKenna Brown, Ed.D.
 2 A. No.
 3 Q. Mr. Sunstein?
 4 A. No; with none of them.
 5 I just remember Leslie Miller saying,
 6 "I'm writing a letter this afternoon and it's going
 7 right over there." That was...
 8 Q. Did Mr. Abdelhak during your first
 9 conversation with him -- by the way, do you think
 10 your call to Mr. Abdelhak was on the same day that
 11 you read the newspaper article?
 12 A. I'm not certain, but very soon thereafter.
 13 Q. Did he have any explanation for not coming to
 14 the board with this prior to the article being
 15 published other than that the executive committee
 16 had approved it?
 17 A. No. Just that the board would have an
 18 opportunity to review all the details at its
 19 subsequent meeting and so on and so forth.
 20 Q. And did that satisfy you at the time?
 21 A. Well, not really. I mean, I just -- it was
 22 done, and so I was not aware that it had ever
 23 happened before and I'm not aware that it ever
 24 happened after that.
 25 Q. I'm sorry. What do you mean "it was done"?

Page 44

1 Dorothy McKenna Brown, Ed.D.
 2 A. I remember I was half asleep, but --
 3 Q. He called you at home at 5:00 a.m.?
 4 A. 5:00, 5:30, something like that. And he just
 5 said he was sorry for any misunderstanding, that he
 6 thought he had operated according to the guidelines
 7 and the bylaws and so on and so forth. And I said
 8 "Well, fine." I appreciated his call and we let it
 9 be.
 10 Q. Did any of the other folks, Miller, Gargalli,
 11 Sunstein, Palmer or Martinelli, talk to you
 12 subsequently about any conversations that they had
 13 with Mr. Abdelhak about this subject?
 14 A. No. I know some of them said they called,
 15 but they didn't talk about the details of the
 16 conversation that I remember.
 17 Q. Did any of your friends or any other
 18 colleagues in Philadelphia tell you that they read
 19 the article and they knew you were on the board?
 20 A. No, I don't remember.
 21 Q. Now, did you ultimately attend the meeting
 22 where the acquisition of Graduate Hospital System
 23 was approved?
 24 A. Yes.
 25 MS. MEADEN: Objection.

<p style="text-align: right;">Page 169</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. No.</p> <p>3 Q. Now, if Coopers & Lybrand had brought such</p> <p>4 matters to the attention of the audit committee,</p> <p>5 would it -- would you have expected the audit</p> <p>6 committee to conduct an investigation into those</p> <p>7 issues raised by Coopers?</p> <p>8 MR. FRIESEN: Objection.</p> <p>9 A. Yes.</p> <p>10 Q. And is it your belief that the committee</p> <p>11 would have conducted a thorough investigation of</p> <p>12 such matters?</p> <p>13 MR. FRIESEN: Objection.</p> <p>14 A. Yes.</p> <p>15 Q. And based on some of your testimony earlier</p> <p>16 today, I sensed that you were never hesitant, if</p> <p>17 issues were presented to you that you were concerned</p> <p>18 about, to inquire further and get answers to the</p> <p>19 questions you had, correct?</p> <p>20 MR. FRIESEN: Objection.</p> <p>21 A. Yes.</p> <p>22 Q. That's a fair statement?</p> <p>23 A. Yes. Why wouldn't I?</p> <p>24 Q. Right, right.</p> <p>25 So if you had ever heard that these</p>	<p style="text-align: right;">Page 171</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 MR. FRIESEN: Objection.</p> <p>3 A. Yes.</p> <p>4 Sorry.</p> <p>5 Q. Do you have any reason to believe that if</p> <p>6 Coopers & Lybrand had ever raised any of these</p> <p>7 issues with the audit committee at AHERF that the</p> <p>8 audit committee would not have conducted any</p> <p>9 investigation into those allegations?</p> <p>10 MR. FRIESEN: Objection.</p> <p>11 A. No.</p> <p>12 Q. If the audit committee had heard such</p> <p>13 allegations from Coopers & Lybrand and had conducted</p> <p>14 such an investigation, it would have been your</p> <p>15 expectation that they would then follow whatever</p> <p>16 prudent course seemed dictated by the results of</p> <p>17 that investigation, correct?</p> <p>18 MR. FRIESEN: Objection.</p> <p>19 A. Yes.</p> <p>20 Q. And if at the end of such an investigation</p> <p>21 the audit committee had come to the board and made a</p> <p>22 recommendation to the board about a course of action</p> <p>23 to follow and had sufficiently satisfied any</p> <p>24 questions that you may have had, would you believe</p> <p>25 that you would have followed the recommendation of</p>
<p style="text-align: right;">Page 170</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 issues that I listed earlier had been raised by</p> <p>3 AHERF's outside auditors and that came to your</p> <p>4 attention, do you believe that you would have either</p> <p>5 conducted an investigation on your own or gone to</p> <p>6 people to insist that they conduct -- the</p> <p>7 appropriate people to insist they conduct such an</p> <p>8 investigation?</p> <p>9 MR. FRIESEN: Objection. Calls for</p> <p>10 speculation.</p> <p>11 A. Yes; not on my own, but I would have gone to</p> <p>12 people that I thought were qualified to do such a</p> <p>13 thing.</p> <p>14 Q. And that would have been members of the audit</p> <p>15 committee?</p> <p>16 A. Right, or the resources.</p> <p>17 Q. Resource management committee, is that what</p> <p>18 you meant?</p> <p>19 A. Committee. I keep calling it a finance</p> <p>20 committee in my head, but it was resources.</p> <p>21 Q. But that's what you were talking about?</p> <p>22 A. Yeah.</p> <p>23 Q. And you certainly would have wanted to know</p> <p>24 what the results of that investigation were had one</p> <p>25 been conducted, correct?</p>	<p style="text-align: right;">Page 172</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 the audit committee in that regard?</p> <p>3 MR. FRIESEN: Objection.</p> <p>4 A. Yes.</p> <p>5 Q. Yes, you would have?</p> <p>6 A. I would, yeah.</p> <p>7 Q. Prior to the fall of 1998, did you ever have</p> <p>8 any question as to the accuracy of AHERF's financial</p> <p>9 statements?</p> <p>10 A. No.</p> <p>11 Q. Did you have any --</p> <p>12 MR. FRIESEN: I'm sorry. Did you say</p> <p>13 fall of 1998?</p> <p>14 MS. MEADEN: Yes.</p> <p>15 MR. FRIESEN: Objection.</p> <p>16 Mischaracterizes the prior testimony.</p> <p>17 MS. MEADEN: I didn't characterize her</p> <p>18 testimony. I asked her a question if she had any.</p> <p>19 MR. FRIESEN: Okay. Contradicts prior</p> <p>20 testimony.</p> <p>21 MS. MEADEN: I don't think it does, but</p> <p>22 all right.</p> <p>23 THE WITNESS: I don't think it does.</p> <p>24 MR. McCLENAHAN: Let's just go to the</p> <p>25 next question. We can have this debate later on.</p>

<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 Q. Did you make any observations as to -- strike</p> <p>3 that.</p> <p>4 Did you come to understand at some point</p> <p>5 that Mr. McConnell had been terminated, his</p> <p>6 employment had been terminated at AHERF?</p> <p>7 A. Yes.</p> <p>8 Q. Did you have any understanding as to why his</p> <p>9 employment was terminated?</p> <p>10 A. No.</p> <p>11 Q. Were you involved in the decision to</p> <p>12 terminate his employment?</p> <p>13 A. No.</p> <p>14 Q. Do you recall during the summer and fall of</p> <p>15 1998, late summer, early fall of 1998, there was</p> <p>16 some question as to whether AHERF's 1997 audited</p> <p>17 financial statements could continue to be relied</p> <p>18 upon?</p> <p>19 A. Yes.</p> <p>20 Q. Tell me how you first learned of that.</p> <p>21 A. I'm not sure. I may have read it in the</p> <p>22 newspaper.</p> <p>23 Q. Do you recall why it was that there was some</p> <p>24 concern as to whether those financial statements</p> <p>25 could continue to be relied upon?</p>	<p>Page 173</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 Q. During that same time period a decision was</p> <p>3 made not to continue to retain</p> <p>4 Pricewaterhousecoopers, which was the successor to</p> <p>5 Coopers & Lybrand?</p> <p>6 A. Right.</p> <p>7 Q. Are you familiar with that decision?</p> <p>8 A. Yes.</p> <p>9 Q. Were you involved in that decision?</p> <p>10 A. No.</p> <p>11 Q. Did you have any understanding as to why that</p> <p>12 decision was made?</p> <p>13 A. I guess because there was a lack of</p> <p>14 satisfaction with the previous audit.</p> <p>15 Q. Did you have any conversations with anyone</p> <p>16 about that --</p> <p>17 A. No.</p> <p>18 Q. -- topic?</p> <p>19 At one point earlier today we were</p> <p>20 looking at Book 3 for a board meeting of 12/16/1994,</p> <p>21 and we don't need to refer to that, but I'm just</p> <p>22 trying to put in context your testimony. And I</p> <p>23 think Mr. Friesen was asking you questions about the</p> <p>24 physician practice acquisition, and I think your</p> <p>25 testimony was that you raised a question at that</p>
<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. No.</p> <p>3 Q. Do you recall that there was a public</p> <p>4 announcement made, I think in September of 1998,</p> <p>5 that those statements should no longer be relied</p> <p>6 upon, the audited financial statements of AHERF for</p> <p>7 fiscal year 1997?</p> <p>8 A. It's a bit of a blur, but I'm sure that I</p> <p>9 knew it when it was announced.</p> <p>10 Q. Were you involved at all in the decision to</p> <p>11 make that public announcement?</p> <p>12 A. No.</p> <p>13 Q. At some point in time did you come to</p> <p>14 question the thoroughness or the competency of</p> <p>15 Coopers & Lybrand's audit of AHERF's financial</p> <p>16 statements?</p> <p>17 M.R. FRIESEN: Objection.</p> <p>18 A. Only after that announcement that they had to</p> <p>19 recast them or --</p> <p>20 Q. Do you recall specifically --</p> <p>21 A. That would be in that September time frame.</p> <p>22 Q. Do you recall having any discussions with</p> <p>23 anyone on the AHERF board or within AHERF management</p> <p>24 about that issue?</p> <p>25 A. No.</p>	<p>Page 174</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 point, do we have enough money to do all of these</p> <p>3 things?</p> <p>4 A. Or sometime prior. In that time frame. I</p> <p>5 don't know if it was at that hearing or not.</p> <p>6 Q. And I think you said that someone answered</p> <p>7 with a definitive yes?</p> <p>8 A. I think it was Sherif.</p> <p>9 Q. That was my question. Do you recall who?</p> <p>10 A. Yes, I think it was Sherif, and I think he</p> <p>11 said we have plenty of money.</p> <p>12 Q. And do you recall until the fall of 1997 Mr.</p> <p>13 Abdelhak giving recurrent assurances to the board</p> <p>14 that the system was financially strong enough to</p> <p>15 absorb acquisitions of hospitals and acquisitions of</p> <p>16 physician practices?</p> <p>17 A. I can't quote him the way I did in that</p> <p>18 particular instance, but, yes, I have a sense that</p> <p>19 we were regularly assured that while there was a lot</p> <p>20 of work to be done, it could be done.</p> <p>21 Q. And, to be clear, you never heard from the</p> <p>22 outside auditors --</p> <p>23 A. No.</p> <p>24 Q. -- that Mr. Abdelhak's assurances in that</p> <p>25 regard were incorrect or inaccurate, correct?</p>

<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. No.</p> <p>3 MR. FRIESEN: Objection.</p> <p>4 Q. Earlier this afternoon Mr. Friesen also</p> <p>5 showed you the 1996 audited financial statements,</p> <p>6 and, again, there is no need to go back and look at</p> <p>7 them. I'm just trying to put in context your</p> <p>8 testimony. And he asked you if you reviewed the</p> <p>9 financial statements as a practice when you got</p> <p>10 them. And I believe your testimony was you</p> <p>11 typically looked at the letter from the auditors and</p> <p>12 the balance sheet and then perhaps looked at</p> <p>13 footnotes if something caught your interest,</p> <p>14 correct?</p> <p>15 A. Yes.</p> <p>16 Q. And I think you said you expected highly</p> <p>17 unusual items to be pointed out by the finance</p> <p>18 committee?</p> <p>19 A. Or the audit committee.</p> <p>20 Q. Or the audit committee?</p> <p>21 A. Or the audit committee.</p> <p>22 Q. And did you in that same vein expect highly</p> <p>23 unusual items to be pointed out by the outside</p> <p>24 auditors?</p> <p>25 A. I would assume they would have been</p>	<p>Page 177</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. The audited.</p> <p>3 Q. Well, what she said was financial statements,</p> <p>4 and I want to be clear what we are talking about</p> <p>5 here.</p> <p>6 A. Okay.</p> <p>7 Q. Did you mean in your answer to talk about</p> <p>8 audited financial statements?</p> <p>9 A. I meant audited financial statements. As I</p> <p>10 indicated earlier, I had great concern when Sheriff</p> <p>11 said, quote, I don't have good numbers.</p> <p>12 Q. That's what I was getting at, and that was</p> <p>13 the source of my confusion.</p> <p>14 The second question I have is with</p> <p>15 respect to the timing of the Graduate acquisition.</p> <p>16 The testimony that you gave about believing that</p> <p>17 there was a period of time within which the Graduate</p> <p>18 entities could be given back to prior management, I</p> <p>19 think you testified in response to Miss Meaden's</p> <p>20 questions that that was during the due diligence or</p> <p>21 trial period?</p> <p>22 A. Yes.</p> <p>23 Q. Now, did you approve of the acquisition</p> <p>24 beyond the trial period, or did you think that</p> <p>25 beyond the trial period you would have to approve it</p>
<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 pointed -- would have been pointed out to the audit</p> <p>3 committee.</p> <p>4 Q. By the outside auditors?</p> <p>5 A. By the outside auditors.</p> <p>6 Q. And, again, you are not aware of Coopers &</p> <p>7 Lybrand ever pointing --</p> <p>8 A. No.</p> <p>9 Q. -- out such highly unusual items to the audit</p> <p>10 committee, correct?</p> <p>11 A. No.</p> <p>12 MR. FRIESEN: Objection.</p> <p>13 MS. MEADEN: Thank you for your</p> <p>14 patience, Dr. Brown. I don't have any further</p> <p>15 questions at this point. Mr. Friesen may,</p> <p>16 BY MR. FRIESEN:</p> <p>17 Q. I just have a few.</p> <p>18 I would like to clarify one thing, Dr.</p> <p>19 Brown. In response to Miss Meaden's question, you</p> <p>20 testified that prior to the fall of 1998 you</p> <p>21 didn't -- I think you said you didn't believe that</p> <p>22 any of AHERF's financial statements were inaccurate?</p> <p>23 A. No, I think she asked if Coopers' financial</p> <p>24 statements were inaccurate.</p> <p>25 MS. MEADEN: The audited.</p>	<p>Page 178</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 again?</p> <p>3 A. Well --</p> <p>4 MS. MEADEN: Objection. Vague.</p> <p>5 Compound.</p> <p>6 Go ahead.</p> <p>7 A. I think there is a -- something you showed me</p> <p>8 here --</p> <p>9 Q. Right.</p> <p>10 A. -- minutes that talk about the final</p> <p>11 presentation by Sheriff, if I'm not mistaken.</p> <p>12 Q. Exhibit 832, which are the minutes of the</p> <p>13 December 12, 1996.</p> <p>14 A. Yes.</p> <p>15 Q. Beginning on Page 743. That's right. Thank</p> <p>16 you.</p> <p>17 The paragraph on 743, the introduction</p> <p>18 there says, "The president," meaning Mr. Abdelhak,</p> <p>19 "reviewed the overall plans underway and steps taken</p> <p>20 to date to accomplish the integration and</p> <p>21 transaction of appropriate GHS activities to AHERF,</p> <p>22 noting that final form of the reorganization will be</p> <p>23 determined as current due diligence reviews and</p> <p>24 other financial legal and operational analyses are</p> <p>25 completed."</p>

<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 A. Yes.</p> <p>3 Q. And then the resolution goes on.</p> <p>4 A. For pages.</p> <p>5 Q. Yes.</p> <p>6 And my question -- and I can point you</p> <p>7 to specific paragraphs of the resolution if you</p> <p>8 like, but before I do that, my question is: Did you</p> <p>9 understand that this resolution gave Mr. Abdelhak</p> <p>10 the authority to finally fold the Graduate entities</p> <p>11 into the AHERF system once due diligence was</p> <p>12 complete? And if you like, I can point to specific</p> <p>13 paragraphs.</p> <p>14 MR. McCLENAHAN: If you have a current</p> <p>15 recollection what this all meant in December of</p> <p>16 1996 --</p> <p>17 THE WITNESS: I don't have a current</p> <p>18 recollection.</p> <p>19 MR. FRIESEN: Well, it may help to look</p> <p>20 at --</p> <p>21 MR. McCLENAHAN: Let me finish.</p> <p>22 -- then you can answer that question.</p> <p>23 But unless you have such a current recollection or</p> <p>24 unless counsel can specifically refresh your memory,</p> <p>25 you shouldn't speculate on what these pages of</p>	<p>Page 181</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 trial period wherein there would be due diligence</p> <p>3 and AHERF would manage the Graduate entities for a</p> <p>4 period of time, or did you think that you were</p> <p>5 approving the ultimate acquisition if due diligence</p> <p>6 turned out to be satisfactory?</p> <p>7 MS. MEADEN: Objection.</p> <p>8 MR. McCLENAHAN: Are you finished?</p> <p>9 MR. FRIESEN: Yes.</p> <p>10 MR. McCLENAHAN: Objection. That</p> <p>11 question is if you have a recollection.</p> <p>12 A. I truly don't remember. If I voted for it, I</p> <p>13 voted for it and I had read the material ahead of</p> <p>14 time, but I don't remember.</p> <p>15 Q. Even apart from this document, since you</p> <p>16 yourself have testified about this trial period, do</p> <p>17 you recall believing when you approved the trial</p> <p>18 period that management would have to come back to</p> <p>19 the board for the final --</p> <p>20 A. Yes.</p> <p>21 Q. -- approval?</p> <p>22 A. Yes.</p> <p>23 Q. And do you recall that ever happening?</p> <p>24 A. No.</p> <p>25 Q. But you recall at some point that Graduate</p>
<p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 resolutions mean or say.</p> <p>3 A. I don't have a current recollection.</p> <p>4 Q. Let me try to refresh your recollection then.</p> <p>5 If you go to Page 745, the middle</p> <p>6 paragraph says --</p> <p>7 MR. McCLENAHAN: Why don't you start at</p> <p>8 the top of that page if we are going to be referring</p> <p>9 to it.</p> <p>10 Q. The middle paragraph says, "Whereas, although</p> <p>11 due diligence reviews are continuing, AHERF</p> <p>12 management has concluded that certain of the</p> <p>13 operations and assets of the GHS subsidiaries should</p> <p>14 be integrated into the AHERF system including,</p> <p>15 without limitation, three of the adult community</p> <p>16 hospitals (the Graduate Hospital, City Avenue</p> <p>17 Hospital and Rancocas Hospital), the physician</p> <p>18 satellite network, and the Bermuda offshore captive</p> <p>19 insurance company, GHS Re, Inc."</p> <p>20 And if you could read to yourself the</p> <p>21 paragraphs on Page 746.</p> <p>22 MR. McCLENAHAN: Is there a question?</p> <p>23 MR. FRIESEN: Yes.</p> <p>24 Q. The question is: Did you think at the time</p> <p>25 during this meeting that you were approving simply a</p>	<p>Page 182</p> <p>1 Dorothy McKenna Brown, Ed.D.</p> <p>2 was actually folded into AHERF?</p> <p>3 A. Yes.</p> <p>4 Q. And when you found out about that, did you</p> <p>5 tell anyone that this should have been brought back</p> <p>6 to the board again?</p> <p>7 MS. MEADEN: Objection.</p> <p>8 A. No.</p> <p>9 MR. FRIESEN: I don't have any further</p> <p>10 questions.</p> <p>11 BY MS. MEADEN:</p> <p>12 Q. I have a couple of followup questions.</p> <p>13 When Mr. Abdelhak said in that meeting</p> <p>14 in I think the May time period of 1998 that he</p> <p>15 didn't have good numbers, was he specifically</p> <p>16 referring to internal financial statements, or was</p> <p>17 he looking at internal financial statements?</p> <p>18 A. I think that's what he was talking about</p> <p>19 because the three more astute financial members on</p> <p>20 that committee were asking him specific questions</p> <p>21 about cash flow and a new word that I learned EB --</p> <p>22 MR. McCLENAHAN: EBITDA.</p> <p>23 Q. EBITDA.</p> <p>24 A. -- EBITDA, and I had to go home and look that</p> <p>25 one up, and things like that. And after some</p>

TAB 189

In The Matter Of:

*AHERF v.
PRICEWATERHOUSE COOPERS, LLP.*

DONALD KAY, M.D.

June 18, 2003

LEGALINK MANHATTAN
420 Lexington Avenue - Suite 2108
New York, NY 10170
PH: 212-557-7400 / FAX: 212-692-9171

KAY, M.D., DONALD



LEGALINK®

A WORDWAVE COMPANY

DONALD KAYE, M.D.,

Page 374	Page 376
1 acquisition. 2 BY MR. McDONOUGH: 3 Q. Now, Dr. Kaye, even including the 4 benefits obtained as a result of the 5 efforts that you described, just 6 described, is it correct that AIHG 7 nonetheless continued to lose a very 8 substantial amount of money? 9 A. Yes, it is. And a lot of the 10 reasons were that the critical mass, the 11 practices, had already been acquired and 12 others were coming on line that had been 13 already either purchased or fairly 14 binding agreements had been made. And 15 so, with the new practices, there were 16 more total losses. 17 Q. And so the reasons for those 18 losses, as I understand your answer, is 19 that much of what was in AIHG was 20 already there and already the basis of 21 agreements at the time you arrived. 22 A. That is correct. And there were 23 others that were committed to, which 24 then came on line and added to the 25 losses.	1 president, do you recall any discussion 2 or reference to the fact of an 3 acquisition phase and then a 4 consolidation phase? 5 A. No. But the termination or 6 slowing down of the acquisition phase is 7 clearly a reference to my intent and 8 efforts to slow it down. 9 Q. How about the referenced term 10 here, "consolidation integration phase"; 11 is that something that means anything to 12 you? 13 A. No. That's his terminology. 14 This -- these were never formally 15 approved terms of anything, but I -- the 16 concept is that he is referring to a 17 need for consolidation, integration, 18 improvement, which I certainly can't 19 disagree with. 20 Q. And in fact, is the process of 21 trying to take what you had at AIHG and 22 make it work in a more consolidated and 23 integrated fashion something you paid 24 attention to as well? 25 A. Work better. I don't know really
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25	Page 375
MR. McDONOUGH: Mark this as the next number, please. MR. KRUSKO: It's 1514. (Exhibit 1514 was marked for identification.) BY MR. McDONOUGH: Q. Dr. Kaye, I'm going to show you what's been marked as Exhibit 1514. It is, first of all, a fax cover page indicating a delivery to you dated October 1st of 1997, and attached to it is something titled the AIHG Policy and Performance. Do you see that? A. Yes. Q. I'd like you to turn to the last page of that exhibit. And in the last paragraph, there is a sentence that reads, In summary, our acquisition phase is complete and our consolidation integration phase is to begin. Do you see that? A. Yes. Q. Dr. Kaye, at any point when you were involved with AIHG as its	1 what's being consolidated or what's 2 being integrated. I'm -- my concern was 3 in terms of making it work better, and 4 that included disease management, more 5 medical direction, more oversight. 6 Q. You can put that to the side. 7 Thank you. 8 Dr. Kaye, do you recall being 9 part of any discussions concerning a 10 proposed acquisition or a possible 11 acquisition of the Graduate Hospital 12 System? 13 A. Yes. I was certainly present when 14 various discussions were held about the 15 Graduate System. 16 Q. Okay. Well, my specific 17 reference, though, was to not any part 18 of the acquisition. I'm talking about 19 discussions about whether there should 20 be an acquisition of the Graduate 21 Hospital System. 22 A. Yes. Again, there were multiple 23 such discussions along the line. 24 Q. And with whom were those 25 discussions held?
	Page 377

DONALD KAYE, M.D.,

<p style="text-align: right;">Page 378</p> <p>1 A. Primarily with Mr. Abdelhak. But 2 also, the various stages and 3 possibilities were discussed at a board 4 level. As a matter of fact, I can't 5 swear to this but I'm pretty sure that 6 the first I heard about the possibility 7 of a Graduate acquisition was at a board 8 meeting.</p> <p>9 Q. And taking first the discussions 10 with Mr. Abdelhak, can you recall for me 11 what was discussed as the pros and cons, 12 pros or cons of proceeding with the 13 Graduate Hospital Acquisition?</p> <p>14 A. Yes. I was asked my opinion. I 15 had the feeling that the basic decision 16 had already been made and, therefore, 17 what I did was gave the pros and the 18 cons as I saw them as opposed to saying 19 yes or no, which I didn't feel would 20 have been very helpful; as with the 21 Hahnemann acquisition, I gave what I 22 felt were the pros and cons.</p> <p>23 I didn't come out for it, for 24 sure, and certainly didn't veto it 25 because I felt it would not have been a</p>	<p style="text-align: right;">Page 380</p> <p>1 hospitals which were very poorly- 2 thought-of, such as the City Line Avenue 3 Hospital, Parkview Hospital, and Sinai, 4 which I saw no future for and I felt 5 basically it should be closed, with the 6 activity moved to our existing hospitals 7 should the acquisition go forward.</p> <p>8 One other pro would be that 9 Graduate Hospital was in a part of the 10 city where we didn't have anything at 11 the time. So those were the pros and 12 the cons.</p> <p>13 Q. At the time the potential 14 acquisition was discussed with 15 Mr. Abdelhak, was it your understanding 16 that the Graduate system was losing 17 money?</p> <p>18 A. At -- we had these discussions at 19 various points in time. I don't think 20 there was one day where we sat down and 21 discussed everything about it, because 22 we had discussions and then there was 23 due diligence being done.</p> <p>24 My understanding is that some 25 of the components were losing money and</p>
<p style="text-align: right;">Page 379</p> <p>1 useful thing to do because it was going 2 to happen anyway.</p> <p>3 Q. And as best you can recollect, 4 what was the basis for your conclusion 5 that it was going to happen anyway?</p> <p>6 A. My feelings and my knowledge of 7 Mr. Abdelhak.</p> <p>8 Q. What were the pros and cons that 9 you recall discussing with Mr. Abdelhak?</p> <p>10 A. As I saw them, the pros were that 11 there was Graduate Hospital, which was a 12 highly-thought-of hospital with a 13 highly-thought-of staff in Philadelphia, 14 that they had a practice organization 15 which was much more efficient than 16 the -- than AIHG. I believe they had -- 17 whether they had taken more care in 18 selecting or whether their contracts 19 were different or whatever, they were 20 not losing large amounts of money.</p> <p>21 The cons I felt were Graduate 22 Hospital, which was a tertiary care 23 hospital, which would be competing with 24 Hahnemann and MCP, both of which were 25 tertiary care hospitals; some very weak</p>	<p style="text-align: right;">Page 381</p> <p>1 some of the components were making money 2 but that, as a whole, they weren't 3 doing -- as a whole, they were not 4 making money. But the thought was that 5 by efficiencies of management, by 6 downsizing their finance department, 7 personnel, all of the other support 8 areas, by extending hours, that there 9 would be efficiencies in the 10 consolidation.</p> <p>11 I was not clearly in favor of 12 the acquisition but I clearly did not 13 veto it because I would -- really wasn't 14 in a position to veto it.</p> <p>15 Q. And I take it from that answer, 16 Dr. Kaye, that shifting to the 17 discussion of the Graduate acquisition 18 at the board level, you did not speak 19 against the possibility.</p> <p>20 A. No. At the board meeting -- the 21 AHERF board meeting anyway, where this 22 would have been primarily discussed -- 23 it was a question of doing due diligence 24 and looking into it and making a 25 determination at a later time as to</p>

DONALD KAYE, M.D.,

Page 382	Page 384
<p>1 whether or not it would be taken into 2 AHERF, as the expression goes. 3 Q. To your -- based on your 4 knowledge, Dr. Kaye, did any member of 5 the AHERF board, at the meeting you 6 reference or any other time in your 7 presence, vote or argue against the 8 Graduate acquisition? 9 A. I believe there was general 10 skepticism from many of the board 11 members. I don't specifically recall 12 any arguments or vetos, but I do recall 13 a general concern and skepticism about 14 the Graduate system. 15 Q. Do you recall that any board 16 member voted against the concept of 17 acquisition? 18 A. No, I don't really actually recall 19 a vote, per se, although I'm certain one 20 must have been taken. 21 Q. Dr. Kaye, I'll show you what's 22 been marked as, previously marked as 23 Deposition Exhibit 751. It is a copy of 24 a news release dated August 6th of 1996. 25 Do you see that?</p>	<p>1 was that SDN was the organization used 2 to acquire the United Hospitals, to 3 manage the United Hospitals while due 4 diligence was being done, and then to 5 transfer the hospitals or other assets 6 that were to be incorporated into 7 AHERF -- to AHERF, and then to sell, 8 close or discontinue other operations 9 that were part of the United Hospital 10 operations. 11 Specifically, I recall that 12 there was an ambulance company and there 13 were several other companies that were 14 either sold or discontinued by SDN. 15 Q. Is it your recollection, Dr. Kaye, 16 that the AHERF board was aware that SDN 17 would be the initial vehicle utilized by 18 AHERF for acquisition of the Graduate 19 Health System? 20 MR. WHITNEY: Objection to 21 form and foundation 22 THE WITNESS: Of the Graduate 23 Health System? Did I realize that -- 24 I know that AHERF was aware 25 of SDN, and I know that the AHERF board</p>
<p>1 A Yes, I do. 2 Q. And to put this in perspective, 3 Dr. Kaye, would that have been in the 4 first quarter of fiscal 1997 for the 5 AHERF eastern hospitals? 6 A. Yes, it would have been. 7 Q. Now, Dr. Kaye, does this assist in 8 refreshing your recollection that the 9 initial announcement of the Graduate 10 Health System occurred during the summer 11 of 1996 or during the early part of the 12 fiscal 1997 year? 13 A. Yes. I know the initial 14 discussions or planning occurred about 15 that time. I am not specifically 16 familiar with this release. 17 Q. This release, Dr. Kaye, 18 indicates -- this press release 19 indicates that the transfer will be 20 accomplished by transferring 21 subsidiaries of GHS, that's the Graduate 22 Health System, to a membership in SDN. 23 What was SDN? 24 A. My best understanding of SDN, the 25 first contact I had in any way with SDN,</p>	<p>1 was told that these hospitals would be 2 under the management of SDN while due 3 diligence was being done, and I know 4 that the AHERF board was told that they 5 would be appraised before -- or, 6 apprised of any further steps and would 7 have to agree to incorporate whatever 8 hospitals of the Graduate system were to 9 be incorporated at a later date. 10 BY MR. McDONOUGH: 11 Q. Now, Dr. Kaye, is it your 12 recollection that due diligence or 13 financial analysis of the Graduate 14 Health System was, in fact, done by the 15 AHERF system? 16 A. It was done by the AHERF finance 17 department. Mr. McConnell was in 18 charge. I reviewed the hospital 19 operations and what existing contracts 20 there were between the hospitals and 21 various physician groups and things like 22 that. 23 Q. To your knowledge -- well, strike 24 that. 25 MR. McDONOUGH: Why don't we</p>

TAB 190

In The Matter Of:

*AHERF v.
PRICEWATERHOUSECOOPERS, LLP*

ROBERT BERLINER

February 16, 2005

LEGALINK MANHATTAN
*420 Lexington Avenue - Suite 2108
New York, NY 10170
PH: 212-557-7400 / FAX: 212-692-9171*

BERLINER, ROBERT - Vol. 1



Page 149

1 Robert Berliner
 2 had many other brands.

3 Q. Have you ever had in your career
 4 any other experience like the one that you
 5 described at American Beverage?

6 A. Yes, I did.

7 Q. What was that experience?

8 A. It was with a company called
 9 Nickelberry that had been a long-standing client
 10 of our Chicago office where there was a
 11 management change and the company relocated to
 12 New York. The company took a position that they
 13 had made a decision to dispose of a line of
 14 business during the year and therefore in the
 15 financial statements they wanted to release they
 16 categorized the operations of this line of
 17 business as a discontinued operation.

18 I'll never forget the situation, we
 19 were working lengthy hours and one night about
 20 8:30 I asked my team, I was the partner and I
 21 asked my team look, I've got to leave now, is
 22 there anything I can read on the train and the
 23 answer was well, why don't you take the minutes
 24 of the board of directors. So I took the
 25 minutes of the board of directors meetings and

Page 151

1 Robert Berliner
 2 that are not all that forthcoming and indeed
 3 managements that lie. Whether they do or not
 4 that does not absolve an auditor of his
 5 responsibilities, otherwise where is the auditor
 6 the watchdog for the public, readers of
 7 financial statements count on the auditor to do
 8 an audit.

9 That's why earlier in the day I
 10 wanted to comment when you asked me about the
 11 management representation letter being an
 12 important procedure, of course it's an important
 13 procedure but on the other hand what is it, of
 14 course you have to get these representations
 15 from management, but that is by no means the
 16 corroboration or the end of what you're supposed
 17 to do. I'm sorry for this prolonged answer, but
 18 I couldn't resist given the question you asked.

19 Q. I can see that. Have you had any
 20 other experiences in your career like American
 21 Beverage or Nickleberry?

22 A. I did, but not all of them that I
 23 can recollect or stand out at this time.

24 Q. There aren't any others that come
 25 to mind at this time?

Page 150

1 Robert Berliner
 2 I'm on the train reading these minutes and it
 3 suddenly dawns on me that haven't I read this
 4 part before, didn't I see this movie. I picked
 5 up what I thought I had seen and there I had in
 6 my hands two versions, two very different
 7 versions of the same board meeting with respect
 8 to this discontinuance of the business, and in
 9 fact they had not made any decision to
 10 discontinue the business.

11 I went back to the CEO and I said
 12 to him as politely as I could how can you
 13 account for the fact that what you told me --
 14 which of these two board minutes is correct and
 15 he blew it, he got all upset and everything and
 16 lost his temper. Bottom line, we took the
 17 discontinued operations, reflected them as
 18 current operations, issued the financial
 19 statements that way and two months later he
 20 appeared in our office to speak to the managing
 21 partner of the office to tell him we were being
 22 fired and replaced as auditors because your
 23 audit partner wouldn't let me put out the false
 24 financial statements that I wanted to put out.

25 I'm use to dealing with managements

Page 152

1 Robert Berliner

2 A. Correct.

3 MR. JONES: Let's take a short
 4 break.

5 THE VIDEOGRAPHER: This marks the
 6 end of tape number 2 in the deposition of Robert
 7 Berliner. We are going off the record, the time
 8 is approximately 2:15 p.m.

9 (Short recess taken.)

10 THE VIDEOGRAPHER: We are back on
 11 the record. Here marks the beginning of tape
 12 number 3 in the deposition of Robert Berliner,
 13 the time is 2:28 p.m.

14 A. Mr. Ryan, may I add to the record
 15 with respect to the Kite testimony?

16 Q. Yes, please.

17 A. I just checked with my colleague
 18 Mr. Zatkow and it's his recollection that we
 19 received the final report of Mr. Kite just prior
 20 to issuing our report, which had been drafted
 21 based upon the oral assurances that Mr. Kite
 22 gave us as to what his opinions would say on the
 23 management we were interested in.

24 Q. As you understand it you didn't
 25 receive the report from Mr. Kite until a matter

<p style="text-align: right;">Page 153</p> <p>1 Robert Berliner 2 of days before you submitted your report? 3 A. That's correct. 4 Q. You in fact had already drafted 5 what was in the report based on an oral 6 communication of Mr. Kite's views? 7 A. That's correct. 8 Q. Thank you. Is it your 9 understanding that in fiscal 1997 AHERF 10 management decided to engage Coopers & Lybrand 11 to perform only an audit of the consolidated 12 system rather than additionally perform separate 13 audits of certain affiliates or obligated 14 groups?</p> <p>15 MR. JONES: Object to form. 16 A. I think I know where you're going 17 and the answer is basically yes, although I 18 would have used different words. It was to 19 report on, they couldn't audit the consolidated 20 without also auditing the consolidating, but the 21 report that I think you're talking about was an 22 audit opinion on the consolidated, as opposed to 23 1996 where they gave separate audit opinions on 24 the obligated groups. 25 Q. That was a change in the scope of</p>	<p style="text-align: right;">Page 155</p> <p>1 Robert Berliner 2 Q. So there was a more lenient 3 standard of materiality in 1997 than there had 4 been in the previous years? 5 A. Yes. 6 MR. JONES: Object to form. 7 Q. Do you agree that because of this 8 change in reporting format, Coopers & Lybrand's 9 audit in fiscal year 1997 was conducted for the 10 purpose of forming an opinion on the 11 consolidated financial statements taken as a 12 whole?</p> <p>13 MR. JONES: Object to form. 14 A. Again, my answer is yes and no. 15 Yes to the extent that that was the only audit 16 opinion expressed. No in that to be able to 17 express that opinion there had to be extensive 18 work on the various components, and particularly 19 to enable Coopers to be in a position to issue 20 its debt compliance letters in connection with 21 the various loan covenants. So there was a 22 modification, but it didn't go from auditing the 23 individual obligating groups to not auditing 24 them at all. 25 Q. Do you agree that in fiscal year</p>
<p style="text-align: right;">Page 154</p> <p>1 Robert Berliner 2 work for Coopers & Lybrand from one year to the 3 next, right? 4 A. Again that needs commentary, it's 5 not an easy answer to that question. There is a 6 yes and a no. The no is that no, they still had 7 to audit the books and records of the various 8 components to be able to reach an opinion on the 9 consolidated financial statements, that's how 10 you audit, you audit the books of each of the 11 components in the consolidated financial 12 statements. The way the scope changes is that 13 the opinion that they would express on the 14 consolidating information would be in all 15 respects material to the consolidated. 16 As a result thereof, the audit 17 scope in terms of materiality, the materiality 18 threshold drops from what would be material to 19 the individual obligated groups -- I'm sorry, it 20 doesn't drop, it increases to the materiality on 21 the consolidated financials taken as a whole so 22 that less work would be required to give the 23 opinion that was given on the consolidating, 24 then if the audit firm had to report 25 individually on each of the obligated groups.</p>	<p style="text-align: right;">Page 156</p> <p>1 Robert Berliner 2 1997 Coopers & Lybrand was not required to 3 conduct an audit for the purpose of forming an 4 opinion on the financial statements of DVOG? 5 MR. JONES: Object to form. 6 A. Yes, there was no reason to express 7 an audit opinion on DVOG because a client didn't 8 request that opinion, but still with respect to 9 the debt compliance letters, the auditing work 10 that was done on DVOG and also the auditing work 11 on DVOG in order to form an opinion on the 12 consolidated financials taken in a whole 13 required extensive auditing procedures to be 14 applied to DVOG's books and records. 15 Q. Do you agree that the supplementary 16 consolidating financial information for DVOG in 17 1997 was subjected to the auditing procedures 18 applied in the audit of the consolidated AHERF 19 financial statements? 20 A. Yes, I do. 21 Q. This change in the report that 22 Coopers & Lybrand was providing is something 23 that is apparent to any reader of the financial 24 statements, is it not? 25 MR. JONES: Object to form and</p>

Page 157

Page 159

1 Robert Berliner

2 foundation.

3 A. What's apparent is they are not
4 getting a separate audit report on the
5 individual obligated groups, but they are
6 getting in lieu thereof a report on the
7 consolidating information.

8 Q. This change in Coopers & Lybrand's
9 reporting obligation was apparent to the AHERF
10 board of trustees, right?

11 MR. JONES: Object to foundation
12 and form.

13 A. I guess so, I have no reason to
14 think otherwise. I don't know for sure to what
15 extent the board of trustees examined the
16 financial statements, I would think they would.

17 Q. Do you agree that this change in
18 Coopers & Lybrand's, the reporting obligation
19 was also apparent to lenders?

20 MR. JONES: Same objection,
21 foundation and form.

22 A. I believe the quid pro quo here was
23 that in lieu of separate audit reports on the
24 individual obligated groups, the lenders would
25 receive a report on the consolidated and a

1 Robert Berliner

2 in reporting format complied with the obligated
3 group debt agreements?

4 A. I am aware of that. I also want to
5 modify what I just said. The board of trustees
6 did review the financial statements and did
7 attach importance to the earnings that were
8 recorded therein.

9 Q. Do you agree with me that as a
10 result of the change in reporting format, the
11 reader of the financial statements was no longer
12 informed of what the bad debt allowance was at
13 individual obligated groups?

14 A. That's correct.

15 Q. And was no longer informed of what
16 that debt expense was at different obligated
17 groups?

18 A. That's correct.

19 Q. And was no longer informed of
20 related party transactions, that is transactions
21 within the AHERF system?

22 A. Correct.

23 Q. Are these in your view then
24 significant reductions in the level of
25 information about DVOG that were provided in

Page 158

Page 160

1 Robert Berliner

2 report, separate report on the consolidating.
3 While a sophisticated lender would realize that
4 the report on the consolidating would give
5 somewhat less assurance let's say on the
6 fairness of presentation of the financial
7 statements of DVOG, the lender would also
8 realize that the report on the consolidating did
9 evidence the fact that auditing procedures were
10 applied on the individual components.

11 Just Mr. Ryan as you read to me for
12 the purpose of expressing an opinion on the
13 consolidated, so they would realize that they
14 were still getting audited financial statements
15 of the individual obligated groups -- sorry,
16 that they were not getting audited financial
17 statements of the individual obligated groups,
18 but they were getting an opinion on the
19 consolidating and that were there to be any
20 material departures from GAAP that were detected
21 in the audit of the consolidated financial
22 statements they would be brought to their
23 attention.

24 Q. Are you aware that Foley & Lardner
25 provided a legal opinion saying that this change

1 Robert Berliner

2 1997 as compared to 1996?

3 A. They are reductions, yes.
4 Q. Do you believe that they are
5 significant reductions?

6 MR. JONES: Object to form.

7 A. I believe they are significant
8 reductions.

9 Q. And they are apparent to any reader
10 of the financial statements who cares to examine
11 them, right?

12 MR. JONES: Objection to
13 foundation.

14 A. The sheer absence of footnotes on
15 the individual components is a significant
16 reduction of information.

17 Q. Do you have any view one way or the
18 other as to whether the legal opinion from Foley
19 & Lardner was reasonable?

20 A. No, I can't evaluate on a law
21 firm's opinion.

22 Q. Nor would you have expected Coopers
23 & Lybrand to have been in a position to second
24 guess Foley & Lardner's opinion, would you?

25 MR. JONES: Object to form.

Page 233		Page 235
1	Robert Berliner	1 Robert Berliner
2	appropriate procedure, and so they gave	2 provide absolute assurance, is it?
3	assurance to someone that nothing came to their	3 A. It is not.
4	attention in the performance of their work on	4 Q. An audit is not a guarantee, is it?
5	this procedure to indicate that the account was	5 A. It is not.
6	overstated, that conveys false assurance to the	6 Q. An auditor is not an insurer, is
7	recipient of that letter, but it's attributable	7 he?
8	to the audit failure as opposed to a false	8 A. He is not.
9	communication, an intentionally false	9 Q. Do you agree that the subsequent
10	communication.	10 discovery that a material misstatement exists in
11	Q. Have you learned that AHERF	11 the financial statements does not in and of
12	management and the law firm of Foley & Lardner	12 itself evidence inadequate planning, performance
13	discovered the error in calculating the Morgan	13 or judgment on the part of the auditor?
14	Guarantee Trust consolidated unrestricted fund	14 MR. JONES: Object to form.
15	balance covenant before the release of the	15 A. I agree.
16	fiscal 1997 audited financial statements?	16 Q. Do you agree that there are certain
17	A. I don't recall.	17 inherent limitations of an audit?
18	Q. Have you heard of the law firm of	18 A. I agree.
19	Foley & Lardner?	19 Q. For instance, auditors only come in
20	A. Yes.	20 for a short period of time to conduct their
21	Q. It is a reputable law firm?	21 audit testing?
22	A. As far as I know.	22 A. Relatively speaking, yes.
23	Q. If you were an auditor would you be	23 Q. Do you agree that an auditor cannot
24	upset if you learned that your client had a	24 test 100 percent of the transactions of a
25	reputable law firm like Foley & Lardner that	25 company, right?
Page 234		Page 236
1	Robert Berliner	1 Robert Berliner
2	knew of debt covenant noncompliance and didn't	2 A. Well, it's not practical for the
3	take any action to have their client tell you,	3 auditor to do so.
4	the auditor, about it?	4 Q. That's part of the inherent
5	MR. JONES: Object to the	5 limitations to an audit to which we were
6	hypothetical.	6 referring to?
7	A. I would be upset.	7 A. Yes.
8	MR. RYAN: We need to change the	8 Q. As a result of that fact, is the
9	tape.	9 concept of selective testing generally accepted
10	THE VIDEOGRAPHER: This marks the	10 as a valid and sufficient basis for the auditor
11	end of tape number 3 in the deposition of Robert	11 to base his opinion on?
12	Berliner. We are going off the record, the time	12 A. It is.
13	is approximately 4:33 p.m.	13 Q. Selective testing is also referred
14	(Short recess taken.)	14 to sometimes as sampling, right?
15	THE VIDEOGRAPHER: We are back on	15 A. Yes.
16	the record. Here marks the beginning of tape	16 Q. So that an auditor may in
17	number 4 in the deposition of Robert Berliner,	17 conducting his audit conduct procedures only on
18	the time is approximately 4:46 p.m., you can	18 a sample of the accounts or on a sample of
19	begin.	19 transactions, right?
20	Q. Mr. Berliner, do you agree that an	20 A. Yes.
21	audit is designed to provide only reasonable	21 Q. That is in accordance with GAAS,
22	assurance of discovering material in the state	22 right?
23	that they exist?	23 A. It is.
24	A. I do.	24 Q. Now if an auditor complies with
25	Q. An audit is not designed too	25 GAAS and does not find material misstatement,

<p style="text-align: right;">Page 237</p> <p>1 Robert Berliner 2 that doesn't necessarily mean he didn't do his 3 job properly, does it? 4 A. That's right. 5 Q. Do you have a sense of how many 6 entries there would be in a given year to the 7 contractual allowance accounts at AHERF? 8 A. Thousands. 9 Q. Of which \$28 million transferred 10 from Graduate to the contractual allowance 11 accounts at DVOG would be only a handful, right? 12 A. Yes. 13 Q. Do you agree that if an auditor 14 were auditing the contractual allowance account 15 which included thousands of journal entries, an 16 auditor would not test each of the thousands of 17 journal entries recorded throughout the year in 18 the general ledger? 19 A. I agree. 20 Q. Would it be fair to say that an 21 auditor is not responsible for recording entries 22 into the books and records of the company? 23 A. That's correct. 24 Q. That's the job of the company and 25 its personnel, right?</p>	<p style="text-align: right;">Page 239</p> <p>1 Robert Berliner 2 Q. Do you agree that an audit 3 performed in accordance with GAAS is also not 4 designed to provide an opinion on company 5 business strategies? 6 A. Yes. 7 Q. Do you agree that an auditor has to 8 rely on his professional judgment in carrying 9 out his audit? 10 A. I agree. 11 Q. Do you agree that judgment is 12 pervasive throughout every aspect of an audit? 13 A. I agree. 14 Q. There are literally hundreds of 15 judgments that are made by an auditor in the 16 course of even the most straightforward audit, 17 isn't that right? 18 MR. JONES: Object to form. 19 A. Hundreds of judgments? 20 Q. Yes. 21 A. It depends upon the entity I guess. 22 Q. For an entity as large as AHERF, 23 the whole AHERF system, there would be hundreds 24 of judgments that would be made during the 25 course of the audit?</p>
<p style="text-align: right;">Page 238</p> <p>1 Robert Berliner 2 A. That correct. 3 Q. As part of the concept I think we 4 mentioned before that the financial statements 5 are the responsibilities of management? 6 A. That's correct. 7 Q. Would you agree that the auditor's 8 primary concern is not with individual 9 transactions or individual journal entries, but 10 with the financial statements taken as a whole? 11 MR. JONES: Object form. 12 A. That is the auditors primary 13 concern, yes. 14 Q. Would you agree that an audit 15 performed in accordance with GAAS is not 16 designed to provide an opinion on the 17 effectiveness of internal controls? 18 MR. JONES: Object to form. 19 A. Yes, I do. 20 Q. Do you agree that an audit 21 performed in accordance with GAAS is also not 22 designed to provide an opinion on the 23 qualifications or effectiveness of company 24 personnel? 25 A. Yes.</p>	<p style="text-align: right;">Page 240</p> <p>1 Robert Berliner 2 A. Yes, I agree. 3 Q. Generally there is no right or 4 wrong answer to any of these matters, right? 5 MR. JONES: Object to form and 6 foundation. 7 A. Any of what matters? 8 Q. The matters on which an auditor 9 exercises judgment. 10 MR. JONES: Object to form and 11 foundation. 12 Q. There is no single right answer. 13 There may be an array of different right answers 14 might be a better way of putting it, is that a 15 fair way of saying it? 16 MR. JONES: Same objection. 17 A. I'm not sure of that. I can 18 envision circumstances where there would be a 19 right answer. 20 Q. And others in which there might be 21 a range of right answers? 22 A. Correct. 23 Q. Would you agree that management 24 possesses knowledge about his business that 25 generally is substantially greater than that of</p>

<p style="text-align: right;">Page 241</p> <p>1 Robert Berliner 2 the outside auditors? 3 A. I agree. 4 Q. That's because the transactions of 5 the entity and its related assets and 6 liabilities are within the direct knowledge and 7 control of management, isn't it? 8 A. Yes, it is. 9 MR. JONES: Objection to form and 10 foundation. 11 Q. The auditor's knowledge of these 12 matters is limited to that acquired through the 13 audit, isn't it? 14 A. That is correct. 15 MR. JONES: Same objection. 16 Q. When we say that the financial 17 statements are the responsibility of management, 18 does that also mean that management is 19 responsible for preparing the financial 20 statements in accordance with GAAP? 21 A. That's correct. 22 Q. Is management responsible for 23 adopting sound accounting policies? 24 A. It is. 25 Q. Is management responsible for</p>	<p style="text-align: right;">Page 243</p> <p>1 Robert Berliner 2 accordance with GAAP, do you agree that that 3 does not mean that the internal control system 4 in place is necessarily deficient? 5 A. Yes. 6 Q. Do you agree that it's probably 7 very difficult, if not impossible, to design an 8 internal control system that would catch even 9 immaterial errors? 10 MR. JONES: Object to form. 11 A. Yes. 12 Q. You agree that the auditors do not 13 play a role in the day-to-day monitoring of the 14 internal control system? 15 A. Yes. 16 Q. Do you agree with me that 17 management has various obligations to the 18 auditor, including that management is supposed 19 to be responsive to the auditor's inquiries? 20 A. Yes. 21 Q. Do you agree with me that 22 management is supposed to furnish the auditor 23 with assistance in locating documents? 24 A. Yes. 25 Q. Do you agree that management is</p>
<p style="text-align: right;">Page 242</p> <p>1 Robert Berliner 2 maintaining the accounting records? 3 A. Yes. 4 Q. And for recording its transactions 5 throughout the year? 6 A. Yes. 7 Q. Is establishing and maintaining an 8 internal control structure also an important 9 management responsibility? 10 A. It is. 11 Q. What are the reasons that 12 management establishes internal controls? 13 A. There are many reasons. With 14 respect to the financial statements it's to 15 assure that they are able to prepare financial 16 statements that fairly present in accordance 17 with GAAP and to assure against the 18 misappropriation of their assets. 19 Q. You agree that no internal control 20 system can provide absolute assurance that the 21 financial statements will be prepared in 22 accordance with GAAP? 23 A. I agree. 24 Q. If that happens, that is that the 25 financial statements are not prepared in</p>	<p style="text-align: right;">Page 244</p> <p>1 Robert Berliner 2 supposed to produce evidence that the auditor 3 asks to see? 4 A. Yes. 5 Q. Do you agree with me that 6 frequently auditors ask the management to have 7 client's personnel prepare certain schedules 8 that the auditor incorporates in his working 9 papers? 10 A. Yes. 11 Q. Do you believe that management has 12 an obligation to cooperate with the auditor in 13 terms of those requests? 14 A. Yes. 15 Q. Do you agree with me that 16 management is obligated to tell the auditors the 17 truth? 18 MR. JONES: Object to form and 19 foundation. 20 A. Yes. 21 Q. Do you agree with me that 22 management is obligated not to withhold any 23 material information? 24 A. Yes. 25 MR. JONES: Object to form and</p>

TAB 191

In The Matter Of:

*AHERF v.
PRICEWATERHOUSECOOPERS, LLP.*

D. PAUL REGAN

March 4, 2005

LEGALINK MANHATTAN
*420 Lexington Avenue - Suite 2108
New York, NY 10170
PH: 212-557-7400 / FAX: 212-692-9171*

REGAN, D. PAUL - Vol. 1



D. PAUL REGAN

<p>1 BY MR. ROSENTHAL:</p> <p>2 Q And if you don't have an opinion with</p> <p>3 respect to that, feel free to say so.</p> <p>4 A It doesn't appear that it was. It had a</p> <p>5 net loss, it had a net loss in 1996, of June 30,</p> <p>6 1996 of \$12 million, and that was after</p> <p>7 considering investment income of \$74,075,000. So</p> <p>8 there was a substantial loss from the fees that it</p> <p>9 charged. The fees that it charged were less than</p> <p>10 its expenses.</p> <p>11 Q In fact, AHERF financed its operating</p> <p>12 needs largely from private philanthropy and</p> <p>13 government grants in addition to its fees; is that</p> <p>14 right? Do you know?</p> <p>15 A Well, looking at the June 30, 1996</p> <p>16 financial statements, it indicates that of the</p> <p>17 \$1,607,000, net patient service revenue was</p> <p>18 \$1,352,000, which -- I have to get a calculator.</p> <p>19 Q That's all right, I'll withdraw the</p> <p>20 question, Mr. Regan. I don't want to slow us</p> <p>21 down.</p> <p>22 A That's okay. If you ask me another</p> <p>23 question that involves, I'll have the calculator</p> <p>24 out.</p>	<p>Page 161</p> <p>1 "organization." And then after the first</p> <p>2 sentence, it starts with the word "The," and so</p> <p>3 does my paragraph. And in that sentence, the line</p> <p>4 between "Non-business organizations and business</p> <p>5 enterprises is not always sharp," which is a</p> <p>6 quote, and then "Since the incidence and relative</p> <p>7 importance of those characteristics, in any</p> <p>8 organization, are different," yes. Through the</p> <p>9 word "different," it's the same as paragraph 7.</p> <p>10 Q There is nothing intervening between the</p> <p>11 first sentence and the second sentence of your</p> <p>12 paragraph that's in Con 4?</p> <p>13 A No.</p> <p>14 Q Is there any reason why you did not use</p> <p>15 quotation marks around this language, which is</p> <p>16 directly quoted from FASB Concept Number 4?</p> <p>17 A No. I could have, and then put an</p> <p>18 ellipse after the word "different," and then put a</p> <p>19 quote after the ellipse.</p> <p>20 Q Now, in F(iii) at the bottom of page 9,</p> <p>21 you say that, "It appears that the readers of</p> <p>22 AHERF's financial statements were focused on the</p> <p>23 financial performance of AHERF."</p> <p>24 Who were the readers of AHERF's financial</p>
<p>Page 162</p> <p>1 Q Okay, I would like you to take a look at</p> <p>2 page 9 of your report, Paragraph F(i). Now, in</p> <p>3 this paragraph, you begin with the statement,</p> <p>4 "This statement focuses on organizations that have</p> <p>5 predominantly non-business characteristics that</p> <p>6 heavily influence the operations of the</p> <p>7 organization."</p> <p>8 Do you see that?</p> <p>9 A I do.</p> <p>10 Q Is that a quotation? I realize there are</p> <p>11 no quotation marks here, but is that language a</p> <p>12 direct quotation from some accounting source?</p> <p>13 A It is taken from FASB, Statement of</p> <p>14 Financial Accounting Concepts, Number 4,</p> <p>15 Paragraph 7, and it's not a direct quotation --</p> <p>16 well, hang on, let me see.</p> <p>17 It looks like through the word different,</p> <p>18 it's taken from paragraph 7.</p> <p>19 Q That's not quite right though, is it,</p> <p>20 sir? Through the word "organization," it's taken</p> <p>21 from paragraph 7, and then there are two</p> <p>22 paragraphs in between.</p> <p>23 A Well, I just read the first statement,</p> <p>24 the first sentence, which brings me to the word</p>	<p>Page 164</p> <p>1 statements that you refer to in that sentence?</p> <p>2 A What I'm referring to are management and</p> <p>3 members of the board.</p> <p>4 Q And management was responsible for</p> <p>5 preparing the financial statements; is that</p> <p>6 correct?</p> <p>7 A Yes.</p> <p>8 Q Now, on what information, that is,</p> <p>9 documents or testimony, did you base your</p> <p>10 conclusion that it appears that the readers of</p> <p>11 AHERF's financial statements were focused on the</p> <p>12 financial performance of AHERF?</p> <p>13 A With respect to management, what I see is</p> <p>14 a number of comments by C&L and its analysis of</p> <p>15 the control environment, where there are a number</p> <p>16 of comments as to management being aggressive,</p> <p>17 management being very mindful of making budget,</p> <p>18 management being focused on achieving earnings</p> <p>19 expectations, management expressing the opinion</p> <p>20 that they can't afford to write off certain</p> <p>21 assets, because of the impact on budget or the</p> <p>22 bottom line.</p> <p>23 There are a number of references in the</p> <p>24 Coopers & Lybrand working papers, which are driven</p>

D. PAUL REGAN

<p style="text-align: right;">Page 165</p> <p>1 from results of operations, targets and 2 achievement. I don't see, for example, ever any 3 discussion of, this is going to hurt our net 4 assets. It's, It's going to hurt our operations. 5 With respect to the board of directors in 6 looking at their deposition testimony, and in 7 reading the minutes, the transcripts of Audit 8 Committee meetings, I see an emphasis on, for 9 example, a chair, Mr. Barnes, he is driven by and 10 very interested in operations.</p> <p>11 Q Cash flow from operations, isn't that 12 right, Mr. Barnes?</p> <p>13 MR. TORBORG: I object to form.</p> <p>14 BY MR. ROSENTHAL:</p> <p>15 Q Doesn't the statement that you quote from 16 Mr. Barnes in your report say that he tended to 17 emphasize cash flow from operations; is that 18 correct?</p> <p>19 MR. TORBORG: I object to form.</p> <p>20 A The first item of cash flow from 21 operations is the bottom line of your statement of 22 operations.</p> <p>23 BY MR. ROSENTHAL:</p> <p>24 Q I want to continue to ask you some</p>	<p style="text-align: right;">Page 167</p> <p>1 number? Decrease in unrestricted net assets. 2 Q Whereas if you were to look at the 3 financial statements of a for-profit company, the 4 last line, the bottom line would be income, 5 correct?</p> <p>6 A It would probably be fully diluted 7 earnings per share.</p> <p>8 Q Well, there is an earnings per share 9 calculation that's below the income statement --</p> <p>10 A Yes, the bottom line you're just talking 11 about. So your bottom line is different than the 12 bottom line we're talking -- (indicating)</p> <p>13 Q Where is the income line?</p> <p>14 A Do I go to the bottom line that says, 15 Fully diluted earnings per share?</p> <p>16 Q Where does the income line occur in the 17 bottom of a statement of income for a for-profit 18 organization?</p> <p>19 MR. TORBORG: I object to form, 20 foundation.</p> <p>21 THE WITNESS: Can I hear that question 22 again?</p> <p>23 (Question read)</p> <p>24 A I don't understand your question, now</p>
<p style="text-align: right;">Page 166</p> <p>1 questions about management and Mr. Barnes, but 2 since you mentioned the term "bottom line," can I 3 ask you, what is the bottom line on AHERF's 4 financial statements, the actual bottom line on 5 the statement of operations?</p> <p>6 A Well, I always equate bottom line with 7 the words "net income," which is on the statement 8 of operations of AHERF.</p> <p>9 If you look at the AHERF financial 10 statements, say, of June 30, 1996, my 11 interpretation of the bottom line is the net loss 12 of \$11,837,000. There's three other numbers that 13 fall below it to have a modest impact, and brings 14 that number down to a loss of, or a decrease in 15 unrestricted net assets of \$8,007,000.</p> <p>16 Q I apologize for asking a simplistic 17 question, but my question is not how do you 18 interpret the phrase "bottom line." I'm asking 19 you, what is the actual last line on the bottom of 20 the page of the AHERF statement of operations?</p> <p>21 A The company notes are an integral part of 22 the consolidated financial statements.</p> <p>23 Q The last line, not the note.</p> <p>24 A Oh, a number, the last line with a</p>	<p style="text-align: right;">Page 168</p> <p>1 that you've confused me about this bottom line 2 process. Because on a for-profit, the bottom line 3 is typically, fully diluted earnings per share.</p> <p>4 BY MR. ROSENTHAL:</p> <p>5 Q If you were confused by my question, I 6 apologize. We will leave it at that.</p> <p>7 What is the title of the statement which 8 contains revenue, expenses, et cetera, for AHERF?</p> <p>9 A In 1996, it's called a Statement of 10 Operations.</p> <p>11 Q And in your experience with a for-profit 12 corporation, are they generally called a statement 13 of income for operations?</p> <p>14 A A lot of times they're called statement 15 of operations.</p> <p>16 Q Now, a short while ago, you had referred 17 to evidence that you had seen in the Coopers & 18 Lybrand work papers of a management interest in 19 maximizing income.</p> <p>20 Some of the examples that you cited, 21 could they be information that you saw, not in the 22 Coopers & Lybrand work papers, but in the numerous 23 examples of internal AHERF management documents 24 that you cite in your report?</p>

D. PAUL REGAN

<p style="text-align: right;">Page 169</p> <p>1 A I would expect that there are some 2 documents, or AHERF documents that make that 3 statement. For example, the statement that "We 4 can't afford to write off these assets," or "We 5 can't afford to establish an appropriate bad debt 6 reserves," that's a statement that I recall as an 7 AHERF management document.</p> <p>8 Q That's the one I was thinking of, thank 9 you.</p> <p>10 Now, you also, did you read Mr. Barnes' 11 entire deposition or just portions of it?</p> <p>12 A My expectation is that I read portions of 13 that deposition.</p> <p>14 Q Do you recall whether the portions of the 15 deposition in the portions of the deposition that 16 you read, Mr. Barnes testified that he did his own 17 calculation of cash flow from the AHERF financial 18 statements?</p> <p>19 A That's consistent with my recollection, 20 yes.</p> <p>21 Q And that he didn't put a lot of stock in 22 the net income number?</p> <p>23 MR. TORBORG: I object to form.</p> <p>24</p>	<p style="text-align: right;">Page 171</p> <p>1 the audit?</p> <p>2 THE WITNESS: Can I hear that question 3 again, please.</p> <p>4 (Question read)</p> <p>5 A I don't know that I'd phrase it that 6 way. I was looking to whether or not the working 7 papers of Coopers & Lybrand indicated to me that 8 Coopers & Lybrand knew or would have known that 9 there were GAAP failures, had Coopers & Lybrand 10 chosen to look at the relevant records or 11 sufficient competent records which would have been 12 made available to them if asked, or they would 13 have seen if they looked.</p> <p>14 BY MR. ROSENTHAL:</p> <p>15 Q I understand that's the way you would put 16 your opinion. I'm asking you a question, however, 17 and my question is did you look to see if there 18 were instances where AHERF management withheld 19 information from the Coopers & Lybrand auditors 20 that would have been significant to the audits?</p> <p>21 A I did not focus on that issue.</p> <p>22 Q You didn't look for it --</p> <p>23 MR. TORBORG: I object to form.</p> <p>24</p>
<p style="text-align: right;">Page 170</p> <p>1 BY MR. ROSENTHAL:</p> <p>2 Q Do you recall reading that in Mr. Barnes' 3 deposition?</p> <p>4 MR. TORBORG: I object to form.</p> <p>5 A I'd need to see that testimony.</p> <p>6 BY MR. ROSENTHAL:</p> <p>7 Q Do you recall in reading the deposition 8 testimony, Mr. Barnes' deposition testimony, 9 whether he made the statement that he thought the 10 quality of earnings for AHERF for 1996 were very 11 poor?</p> <p>12 A I don't have a specific recollection of 13 reading that.</p> <p>14 Q We talked earlier about your credentials 15 as a certified fraud examiner. Did you bring any 16 of those credentials to bear in examining the 17 conduct of management, AHERF management in this 18 case?</p> <p>19 A No, I didn't look at my role or my scope 20 of my work as being a fraud examiner.</p> <p>21 Q Did you look to see if there were 22 instances where AHERF management withheld 23 information from the Coopers & Lybrand auditors 24 that would have been significant to the conduct of</p>	<p style="text-align: right;">Page 172</p> <p>1 BY MR. ROSENTHAL:</p> <p>2 Q -- to see whether there were such 3 instances?</p> <p>4 A No, I looked to whether or not the 5 information that was collected by Coopers & 6 Lybrand and the kind of records that were made 7 available to it, when married to the type of GAAP 8 failures that were identified, would have provided 9 C&L with the information that there was a 10 misstatement, or it would have alerted C&L to the 11 need for reviewing the books of the original entry 12 and other available documents to cure whatever 13 deficiencies in a sufficient competent evidential 14 manner existed in connection with an analysis of 15 an account or accounts.</p> <p>16 Q So is it possible, sir, that there were 17 instances where AHERF management withheld 18 information from Coopers & Lybrand that would have 19 been significant to the audits, but you did not 20 look for them?</p> <p>21 MR. TORBORG: I object to form.</p> <p>22 A That's not something that I did. But it 23 became, I think, clear to me that the failings of 24 GAAP resided within the financial statements, in</p>

D. PAUL REGAN

<p>1 the accounting records; and that Coopers & Lybrand 2 was aware or would have been aware of those 3 failings had they looked at the appropriate 4 records, which I have every reason to believe were 5 made available to it.</p> <p>6 BY MR. ROSENTHAL:</p> <p>7 Q Which appropriate records are you 8 referring to and why do you believe they were made 9 available?</p> <p>10 MR. TORBORG: I object to form. 11 Compound.</p> <p>12 A Journal entries, general ledgers, agings 13 of accounts payable and application of percentages 14 of reserves for bad debts on those percentages, 15 and the depositions of AHERF persons who indicate 16 that when they were asked for records by Coopers & 17 Lybrand, they made those records available; and 18 when they were asked questions by Coopers & 19 Lybrand, they answered the questions that were 20 asked.</p> <p>21 BY MR. ROSENTHAL:</p> <p>22 Q Are you aware of whether there were 23 internal schedules used by AHERF management that 24 contained notes which detailed some of the matters</p>	<p>Page 173</p> <p>1 on those books of original entry rather than the 2 spreadsheets you're talking about.</p> <p>3 Q Sir, is it the case that auditors in the 4 course of performing a GAAS audit don't audit all 5 of the general ledger and journal entries of the 6 company, as a general matter?</p> <p>7 A As a general matter, they select entries 8 of interest based upon risk assessment and 9 knowledge of the facts and circumstances they gain 10 as a result of their audit or audit plan.</p> <p>11 Q And might an auditor choose to select 12 certain journal entries for examination, if 13 presented with a schedule that had such a footnote 14 as we've been discussing? Might that direct the 15 auditor to examine the journal entries that you're 16 describing?</p> <p>17 A If there is such a footnote, I think it 18 might make the task a bit easier. However, in 19 this circumstance, I think the auditor, there is 20 overwhelming reason for the auditor to examine the 21 entries which were listed on that page, given the 22 size of the entries, the effect of the entries on 23 DVOG, and the probability of where those entries 24 were coming from.</p>
<p>1 that you have concluded were accounting 2 irregularities, and yet when those, when similar 3 schedules were provided to Coopers, some of those 4 notes were removed? Are you aware of that fact?</p> <p>5 A I'm aware, for example, that Coopers was 6 given schedules which did not have all of the 7 words which are on other schedules. Whether, when 8 Coopers was given those schedules, they were 9 removed, I don't know the answer to that question. 10 It could be that they were merely given schedules 11 which did not contain notes that were made by 12 others or at a later time.</p> <p>13 Q And would you agree that all of the words 14 in your last answer were significant words that 15 would have alerted the auditors to the potential 16 existence of accounting irregularities?</p> <p>17 A I would agree that in the example I'm 18 thinking of, those words are yet one way in which 19 it would have led C&L to have a better 20 understanding of the transactions, but that that 21 was only one of the ways in which Coopers would 22 have found out; and that the better records are in 23 fact the journal entries themselves, the books of 24 original entry of AHERF, and they certainly were</p>	<p>Page 174</p> <p>1 Q But you agree that the presence of the 2 footnote would certainly be likely to cause the 3 auditor to check, a reasonable auditor to check 4 the underlying journal entries?</p> <p>5 MR. TORBORG: I object to form.</p> <p>6 A I think the auditor is going to be doing 7 that anyway, given the nature of the analysis. He 8 doesn't need to be grabbed by the nose and pushed 9 into the garbage. I mean, he's going to look at 10 those entries anyway, or she.</p> <p>11 BY MR. ROSENTHAL:</p> <p>12 Q Are you aware, sir, that the person 13 principally responsible for making the journal 14 entries in this area of DVOG's books has testified 15 in this case that she knew Coopers did not 16 generally audit those journal entries?</p> <p>17 MR. TORBORG: I object to form and 18 misstates prior testimony.</p> <p>19 MR. ROSENTHAL: To hell it does.</p> <p>20 MR. TORBORG: Okay.</p> <p>21 MR. WHITNEY: I move to strike that.</p> <p>22 A That would strike me as disingenuous, 23 because there hadn't been such entries in the 24 past. There hadn't been entries where</p>

D. PAUL REGAN

Page 185

1 BY MR. ROSENTHAL:

2 Q My question is a little different than
 3 the one you're answering, sir. My question is not
 4 whether or not notwithstanding any efforts by
 5 management to conceal information, Coopers &
 6 Lybrand could have nonetheless detected it.

7 I'm simply asking whether you saw any
 8 evidence during the 15,000-plus hours that your
 9 team worked on this matter over four years' time
 10 of management concealing information from
 11 Coopers & Lybrand?

12 MR. TORBORG: I object to form.

13 A For example, I noted the document that
 14 you describe with respect to the notes, but I
 15 don't consider that evidence of a concealment.
 16 It's evidence that there is another version of a
 17 document that doesn't have as many notes as
 18 another version of a document. To me, that didn't
 19 matter.

20 These are entries in an area of high risk
 21 and entries in an area where the entries, the
 22 books of original records that are under
 23 examination need to be reviewed. Evidence needs
 24 to be gathered about those journal entries, not

Page 187

1 MR. TORBORG: I object to the instruction
 2 and I object to form.

3 MR. ROSENTHAL: It's not an instruction.
 4 I'm seeking to determine whether the witness
 5 understands my question, since each time I ask
 6 him, he answers by answering a question I did
 7 not ask.

8 MR. TORBORG: I object to the
 9 introduction, and I object to the form.

10 MR. ROSENTHAL: And I object to the
 11 speaking objections.

12 A Is there a question?

13 BY MR. ROSENTHAL:

14 Q Do you understand that my questions are
 15 not about whether or not such facts, if you
 16 discovered them, would have been significant to
 17 your findings.

18 I'm simply asking whether you came across
 19 facts in the course of four plus years' work on
 20 this matter, where you saw evidence of management
 21 concealing information, management withholding
 22 information, and I have a few other in the same
 23 vein, but do you understand that my questions are
 24 not about whether they go to your opinion about

Page 186

1 spreadsheets. Just look at the journal entries,
 2 that's what you're auditing. That's what's
 3 important to me.

4 Q Did you identify in the 15,000 plus hours
 5 that your team worked on this matter over four
 6 years' time, any evidence of management
 7 withholding information from Coopers & Lybrand?

8 MR. TORBORG: I object to form.

9 A I didn't identify any meaningful behavior
 10 which I would describe in that way. Certainly I
 11 read the testimony you described, where the
 12 interviewee was to answer the questions asked. It
 13 is not uncommon, it is not surprising, and I don't
 14 view that as significant to my findings, because
 15 of the other facts and circumstances that were in
 16 place, the other information that was available
 17 that is more competent and more appropriate to be
 18 reviewed.

19 BY MR. ROSENTHAL:

20 Q Sir, you understand I'm not asking you
 21 whether these facts would be significant to your
 22 findings. I'm just asking whether you identified
 23 such facts. Do you understand that that's my
 24 question?

Page 188

1 the adequacy of the audit?

2 MR. TORBORG: Objection. That question
 3 has been asked and answered at least four
 4 times in this deposition.

5 MR. ROSENTHAL: It's been asked, it
 6 hasn't been answered.

7 MR. TORBORG: It has been answered. It's
 8 because you have an idea of what you believe
 9 the word "withholding" means and what you
 10 believe the word "concealment" means --

11 MR. ROSENTHAL: This is so beyond the
 12 bounds of acceptable objections. This gives
 13 new meaning to speaking objections.

14 MR. TORBORG: You are berating our
 15 witness for not answering questions and he has
 16 answered questions.

17 MR. ROSENTHAL: The witness has
 18 considerably more experience answering
 19 questions than I have asking them. I think he
 20 can handle himself.

21 Now, sir --

22 MR. WHITNEY: He answered the question
 23 you're fighting with him about. If you go
 24 back and ask the reporter the original

D. PAUL REGAN

<p style="text-align: right;">Page 189</p> <p>1 question you asked him about concealing 2 information, listen to his answer, he answered 3 the question, and then he gave a further 4 statement. And you and he are talking about 5 that further statement, but the question was 6 answered.</p> <p>7 BY MR. ROSENTHAL:</p> <p>8 Q Okay, but do you understand, sir, that 9 I'm not asking you a question that relates to the 10 further statement? I'm asking you simply about 11 whether you uncovered such evidence in the course 12 of your review.</p> <p>13 MR. TORBORG: And which evidence is that?</p> <p>14 MR. ROSENTHAL: The prior two questions 15 about concealing information, withholding 16 information. I just want to understand if the 17 witness understands my question.</p> <p>18 MR. TORBORG: Objection, compound.</p> <p>19 A I did not -- first of all, I'm looking 20 and I'm trying to retain things that I think are 21 significant. If I encounter something that I 22 viewed as insignificant or inconsequential, I 23 don't try to retain it. So I didn't bring 24 anything with me today in my head that struck me</p>	<p style="text-align: right;">Page 191</p> <p>1 they had sufficient information?</p> <p>2 MR. TORBORG: I object to form.</p> <p>3 A No.</p> <p>4 BY MR. ROSENTHAL:</p> <p>5 Q Did management, in your opinion, AHERF 6 management commit intentional fraud?</p> <p>7 MR. TORBORG: I object to form.</p> <p>8 A I haven't been asked to attempt to make 9 that determination, and as a result, I don't have 10 an opinion with respect to that issue.</p> <p>11 BY MR. ROSENTHAL:</p> <p>12 Q So you don't have an opinion as to 13 whether or not management intentionally misstated 14 the financial statements?</p> <p>15 A That's not something that I've been asked 16 to opine on, and as a result, I haven't focused 17 and structured my work to lead me to be able to 18 give an opinion in that area and be able to 19 provide an appropriate basis for it.</p> <p>20 Q Do you agree, sir, that because the 21 characteristics of irregularities, a properly 22 designed and executed audit may not detect a 23 material irregularity?</p> <p>24 A I recognize that that's a possibility in</p>
<p style="text-align: right;">Page 190</p> <p>1 as important, along the lines of your question. 2 So I don't have anything in my head that relates 3 to that particular question.</p> <p>4 BY MR. ROSENTHAL:</p> <p>5 Q In the four plus years of work done by 6 you and your team on this matter, did you note any 7 evidence of collusion within the company or with 8 third parties with respect to information that was 9 not provided to Coopers & Lybrand?</p> <p>10 MR. TORBORG: I object to form.</p> <p>11 A No, I'm of the opinion that Coopers & 12 Lybrand had what it needed.</p> <p>13 BY MR. ROSENTHAL:</p> <p>14 Q Again, sir, my question is, did you see 15 any evidence of collusion to withhold information?</p> <p>16 MR. TORBORG: Asked and answered.</p> <p>17 A And your last words were not provided to 18 Coopers & Lybrand, and I think that Coopers & 19 Lybrand was provided with sufficient matters on 20 the issues that are in play in this case.</p> <p>21 BY MR. ROSENTHAL:</p> <p>22 Q Given that qualification in your answer, 23 is it the case that you saw evidence of collusion 24 that didn't matter to Coopers & Lybrand, because</p>	<p style="text-align: right;">Page 192</p> <p>1 an audit.</p> <p>2 Q Do you agree that audit procedures that 3 are effective for detecting a misstatement that is 4 unintentional may be ineffective for detecting a 5 misstatement that is intentional?</p> <p>6 A I can envision facts and circumstances 7 where that could occur.</p> <p>8 Q Were there some members of AHERF 9 management who were certified public accountants?</p> <p>10 A It's my recollection, yes.</p> <p>11 Q And do certified public accountants have 12 obligations, professional obligations beyond those 13 of ordinary employees who are not CPAs?</p> <p>14 A I believe so. I think that's been 15 discussed in my rebuttal report.</p> <p>16 Q And what are the nature of the additional 17 responsibilities, professional responsibilities 18 that certified public accountants have, beyond 19 those of ordinary employees?</p> <p>20 MR. TORBORG: I object to form.</p> <p>21 A My recollection is that, in my rebuttal 22 report, what I commented on was the auditor's 23 responsibility. I think Mr. Tillett discussed the 24 responsibilities and included that in his report.</p>

D. PAUL REGAN

<p style="text-align: right;">Page 193</p> <p>1 If you have a copy of those pages, I'd be happy to 2 look at them and see to the extent I agree. 3 BY MR. ROSENTHAL: 4 Q Well, we will return to this subject. 5 Do you agree that the auditor's opinion 6 on the financial statements is based, in the 7 context of a GAAS audit, is based on the concept 8 of reasonable assurance? 9 A Yes. 10 Q And do you agree that because the 11 auditor's opinion on the financial statements is 12 based on the concept of reasonable assurance, the 13 auditor is not an insurer of the financial 14 statements? 15 A I agree with that. 16 Q Do you agree that the auditor is not a 17 guarantor -- 18 A I agree with that. 19 Q -- of the financial statements? 20 A Yes. 21 Q Do you also agree that the subsequent 22 discovery that a material misstatement exists in 23 the financial statements for a given period, does 24 not in and of itself evidence inadequate planning,</p>	<p style="text-align: right;">Page 195</p> <p>1 her view on behalf of Mellon Bank that a number of 2 the Lockhart trusts are restricted trusts within 3 the meaning of, she doesn't use the accounting 4 terms, but her description is such that it 5 qualifies as restricted within the meaning of 6 FAS 116 and 117 and 124; is that right? 7 MR. TORBORG: I object to form. I think 8 you misspoke. 9 THE WITNESS: You said Ms. Gordon. 10 MR. ROSENTHAL: I'm sorry, Ms. Robinson. 11 MR. TORBORG: I have a further objection 12 to form as well. 13 MR. ROSENTHAL: Well, let me withdraw 14 that. 15 Q Why don't you read the document and then 16 I will have some questions. 17 A Okay, I looked at the document. 18 Q Now, you understand, sir, that these 19 trusts had a principal also known as a corpus, and 20 generated interest, correct? 21 A Yes. 22 Q And that there was language in the trust 23 agreements that refer to what counted as income 24 and what counted as part of the corpus or</p>
<p style="text-align: right;">Page 194</p> <p>1 performance or judgment on the part of the 2 auditor? 3 A Yes. 4 Q I'm going to hand you what has previously 5 been marked as Exhibit 435, there are a few 6 versions of this floating around. You may have 7 seen one that has a different number on it. 8 But do you recognize the document that 9 has been marked as Exhibit 435? 10 A Yes. 11 Q And Exhibit 435 is a document, a letter, 12 addressed to a Mr. Mike Martin, vice president and 13 treasurer of AHERF from Barbara K. Robinson, Vice 14 President of the Mellon Bank, and then it has 15 handwriting on it. Is that right? 16 A It does, yes. 17 Q Do you know whether the Mellon Bank was 18 the trustee for a number of trusts that existed on 19 behalf of AHERF? 20 A I believe it was. 21 Q Now, have you read the letter that is the 22 underlying document in Exhibit 435? 23 A Yes. 24 Q Does Ms. Gordon set out in Exhibit 435</p>	<p style="text-align: right;">Page 196</p> <p>1 principal of the trust, right? 2 A Yes. 3 Q And that one issue with respect to 4 classification of the trusts on the financial 5 statements of AHERF, was whether gains from 6 appreciation and value, or from, at point of sale, 7 on part of corpus, counted as income or was to be 8 put back to the corpus? Do you understand that? 9 A I do. 10 Q And does Ms. Robinson express the view on 11 behalf of Mellon Bank, the trustee of these 12 trusts, that for most of these trusts, the gains 13 from any disposition or sale of part of the trust, 14 the corpus, was to be put back to the corpus? 15 MR. TORBORG: I object to form. 16 BY MR. ROSENTHAL: 17 Q That is, it was not part of income within 18 the meaning of the trust agreements? 19 MR. TORBORG: I object to form. 20 A Yes, her second paragraph indicates, or 21 she states that, (Reading) My review indicates a 22 mixed response. Several of the trusts are quite 23 explicit, that only income is available. 24</p>

D. PAUL REGAN

<p>1 of entries, journal entries, relating to 2 contractual allowances, you would not expect the 3 auditor to examine each of those journal entries, 4 correct?</p> <p>5 A No.</p> <p>6 Q And that approach of selective testing 7 and audit sampling is used in audits and generally 8 accepted as a standard audit approach, is it not?</p> <p>9 A Yes, you need to do risk assessment, and 10 based upon the risk assessment, you design at 11 first the depth and breadth of audit procedures 12 that are appropriate, given the facts and 13 circumstances and the findings, that are learned 14 by the auditor during the planning process, during 15 its prior relationship with the client, and during 16 the course of the current engagement.</p> <p>17 It's a constant assessment made by the 18 auditor of risks of misstatement and need for 19 sampling and analysis.</p> <p>20 MR. ROSENTHAL: I'm told there is five 21 minutes left on the tape, so why don't we 22 switch tapes.</p> <p>23 THE VIDEOGRAPHER: This marks the end of 24 Tape Number 3 in the deposition of Paul Regan.</p>	<p>Page 209</p> <p>1 A I believe I've heard that statement. I 2 don't recall when they received such a letter.</p> <p>3 Q Well, if you were the auditor of AHERF 4 and you were to subsequently learn after the 5 issuance of the fiscal 1997 audit financial 6 statements, that management had such a letter 7 prior to the issuance of those financial 8 statements, would it upset you, as the auditor, 9 that they had such a letter and hadn't provided it 10 to you?</p> <p>11 A I certainly would want to know what their 12 bases for not concurring with the letter and 13 acting accordingly, you know, what was the other 14 information which the company or management, 15 certain persons within management relied upon, 16 rather than the letter. And based upon that 17 answer, based upon that answer, that would 18 influence my reaction.</p> <p>19 Q And you wouldn't be in a position to ask 20 those questions about what did you rely on rather 21 than the letter, if you didn't know about the 22 letter, correct?</p> <p>23 A That's correct.</p> <p>24 Q Would you agree that auditors have as</p>
<p>Page 210</p> <p>1 We are going off the record at 3:27. 2 (Whereupon a recess was taken, after 3 which the following proceedings 4 were held:)</p> <p>5 THE VIDEOGRAPHER: Here begins Tape 6 Number 4 in the deposition of Paul Regan.</p> <p>7 We're going back on the record at 3:31.</p> <p>8 BY MR. ROSENTHAL:</p> <p>9 Q Mr. Regan, you offer an opinion that 10 AHERF calculated compliance with the Morgan 11 Guarantee Trust, consolidated unrestricted fund 12 balance portion of an indenture agreement between 13 AHERF and Morgan Guarantee Trust, correct?</p> <p>14 A Yes.</p> <p>15 Q Have you learned that AHERF management 16 obtained a letter from Foley & Lardner, a law 17 firm, offering its opinion that management had 18 incorrectly calculated the unrestricted fund 19 balance?</p> <p>20 A I believe I've heard that.</p> <p>21 Q So you're aware that management had a 22 letter from Foley & Lardner, the conclusion of 23 which was that there was noncompliance with the 24 debt covenant?</p>	<p>Page 211</p> <p>1 their primary concern, not individual 2 transactions, but the financial statements taken 3 as a whole?</p> <p>4 A As a general rule, yes. But when they're 5 actually doing the audit and they become aware of 6 individual transactions, they can become very 7 concerned about those transactions.</p> <p>8 Q Does knowledge that an auditor gains in 9 its prior audits accumulate and contribute to 10 their ensuing audits?</p> <p>11 A Yes.</p> <p>12 Q Would you agree that not all of that 13 accumulated knowledge needs to be, or even 14 practically, could be documented?</p> <p>15 MR. WHITNEY: I'll object as compound.</p> <p>16 A I agree that not all cumulative knowledge 17 can be documented, but significant findings, 18 conclusions, concerns, should be documented.</p> <p>19 BY MR. ROSENTHAL:</p> <p>20 Q Would you agree that management possesses 21 a knowledge about its business that is 22 substantially greater than its outside auditors?</p> <p>23 A I would agree that it is generally the 24 case, that's the expected case. I don't know that</p>

D. PAUL REGAN

<p style="text-align: right;">Page 213</p> <p>1 it's always true, but it's the expected case.</p> <p>2 Q Would you agree that management is</p> <p>3 responsible for the performance of the company and</p> <p>4 not its auditors?</p> <p>5 A Generally I agree that that as a general</p> <p>6 statement is correct. There certainly will be</p> <p>7 certain aspects of a company that may be the</p> <p>8 responsibility of the auditors.</p> <p>9 Q Would you agree that management is</p> <p>10 responsible for preparing the company's financial</p> <p>11 statements?</p> <p>12 A Generally, that's the expectation. The</p> <p>13 reality is sometimes the auditor does that.</p> <p>14 Q In the case of AHERF, did management</p> <p>15 prepare the financial statements?</p> <p>16 A That's my expectation, that management</p> <p>17 prepared the financial statements.</p> <p>18 Q Would you agree that the accounting</p> <p>19 estimates that are reflected or incorporated in a</p> <p>20 company's financial statements are management's</p> <p>21 estimates?</p> <p>22 A They should be.</p> <p>23 Q And the auditor's role is limited to</p> <p>24 assessing the reasonableness of management's</p>	<p style="text-align: right;">Page 215</p> <p>1 A (Reading) The concept of materiality</p> <p>2 recognizes that some matters, either individually</p> <p>3 or in the aggregate, are important for a fair</p> <p>4 presentation of financial statements in conformity</p> <p>5 with generally accepted accounting principles.</p> <p>6 Q And then there are three dots. That's an</p> <p>7 ellipses, right?</p> <p>8 A Yes.</p> <p>9 Q That indicates that material has been</p> <p>10 omitted?</p> <p>11 A Correct.</p> <p>12 Q What words were omitted from AU 312.03</p> <p>13 that follow the word "principles"?</p> <p>14 A "While other matters are not important."</p> <p>15 Q Why did you leave those words out from</p> <p>16 your description of the concept of materiality,</p> <p>17 the quote that you have here?</p> <p>18 A The statement that is quoted is that the</p> <p>19 concept of materiality recognizes that some</p> <p>20 matters, either individually or in the aggregate,</p> <p>21 are important. That certainly implies that some</p> <p>22 are not. I think that's kind of, that's really</p> <p>23 not necessary. I wanted to focus on the fact</p> <p>24 that some matters are important individually or</p>
<p style="text-align: right;">Page 214</p> <p>1 estimates, is that true?</p> <p>2 MR. WHITNEY: Objection, foundation.</p> <p>3 A That's the way it often works. Sometimes</p> <p>4 in a particular account, a warranty reserve or a</p> <p>5 bad debt reserve, the auditors will make a</p> <p>6 determination and there will be a discussion and</p> <p>7 consultation, and then it might be recorded to the</p> <p>8 amount that's done by the auditor. But generally,</p> <p>9 you expect management to do that. You certainly</p> <p>10 want management to do that.</p> <p>11 BY MR. ROSENTHAL:</p> <p>12 Q Are all accounting entries that violate</p> <p>13 accounting rules material to the financial</p> <p>14 statements taken as a whole?</p> <p>15 A That would not be what my expectation is.</p> <p>16 I would think that there are some that are not.</p> <p>17 Q Would you take a look at page 15 of your</p> <p>18 report, Paragraph 14(A).</p> <p>19 A Page 15, paragraph?</p> <p>20 Q 14(A) -- I'm sorry, not 14, 4.</p> <p>21 A 4(A)?</p> <p>22 Q Yes, 4(A). And specifically, actually,</p> <p>23 subparagraph 2, you have a quote here. Can you</p> <p>24 read that quote for me, please?</p>	<p style="text-align: right;">Page 216</p> <p>1 in the aggregate.</p> <p>2 What we're here to talk about and address</p> <p>3 in this report are those matters that are</p> <p>4 important. I think that the part quoted implies</p> <p>5 that the other words, and the other words are not</p> <p>6 important. We're not talking about matters that</p> <p>7 are not material.</p> <p>8 Q I'm a bit confused by your answer. I'm</p> <p>9 not sure, are you saying that these words are --</p> <p>10 you omitted the words "while other matters are not</p> <p>11 important," because that's clear and implied from</p> <p>12 what is there? Or are you saying, you omitted</p> <p>13 them because that's a part of the concept that you</p> <p>14 were not trying to address here?</p> <p>15 A I think both. Also, this paragraph goes</p> <p>16 on after that and --</p> <p>17 Q But the sentence ends with those words,</p> <p>18 right?</p> <p>19 A The sentence ends with the words --</p> <p>20 Q "While other matters are" --</p> <p>21 A "while other matters are not important."</p> <p>22 MR. WHITNEY: Let's all talk separately</p> <p>23 here, guys.</p> <p>24 A The sentence ends with the words, "while</p>

D. PAUL REGAN

<p>1 other matters are not important."</p> <p>2 BY MR. ROSENTHAL:</p> <p>3 Q Now, if you look at 4(A)(i), you begin</p> <p>4 that passage with an ellipse. What is left out</p> <p>5 here?</p> <p>6 A There is a prior sentence that says, the</p> <p>7 existence of audit risk is recognized by the</p> <p>8 statement in the auditor's report that the auditor</p> <p>9 obtain reasonable assurance about whether the</p> <p>10 financial statements are free of material</p> <p>11 misstatement.</p> <p>12 Q And why did you leave that statement out</p> <p>13 of Paragraph 4(A)(i)?</p> <p>14 A Because I think that the second sentence</p> <p>15 is the sentence which is particularly important to</p> <p>16 understanding my report and what audit risk is.</p> <p>17 Audit risk is the risk that the auditor</p> <p>18 may unknowingly fail to appropriately modify his</p> <p>19 opinion on the financial statements that are</p> <p>20 materially misstated. That's what I wanted to</p> <p>21 drive home. That's what audit risk is. Her</p> <p>22 sentence doesn't, doesn't really tell that story.</p> <p>23 Q Now, sir, if you will take a look at (v)</p> <p>24 at the top of page 16, you have a quote from</p>	<p>Page 217</p> <p>1 got to make judgments as to, well, what are the</p> <p>2 important aspects that you're trying to</p> <p>3 communicate? Because I can't insert this book and</p> <p>4 all the FASs that it relates to. I've got to pick</p> <p>5 those items, which I think are relevant and</p> <p>6 reliable to my opinion.</p> <p>7 Q So that example was not relevant to</p> <p>8 illustrate what that statement from AU 312 was</p> <p>9 describing?</p> <p>10 MR. WHITNEY: Objection, asked and</p> <p>11 answered.</p> <p>12 A I don't think so. I don't think it is</p> <p>13 relevant to the case. I mean, we don't have an</p> <p>14 illegal payment that I'm aware of.</p> <p>15 BY MR. ROSENTHAL:</p> <p>16 Q Precisely.</p> <p>17 Now, on page 7 to 8 of your report, you</p> <p>18 have a listing of the hierarchy of GAAP, generally</p> <p>19 accepted accounting principles; is that right?</p> <p>20 A 7 and 8 is a discussion of generally, the</p> <p>21 nature of generally accepted accounting</p> <p>22 principles, and I described the sources of</p> <p>23 established accounting principles. My reference</p> <p>24 to, in Footnote 10, to SAS-69, which, as we've</p>
<p>1 AU 312.07, "As a result of the interaction of</p> <p>2 quantitative and qualitative considerations in</p> <p>3 materiality judgments, misstatements of relatively</p> <p>4 small amounts that come to the auditors' attention</p> <p>5 could have a material effect on the financial</p> <p>6 statements."</p> <p>7 Do you see that?</p> <p>8 A Yes.</p> <p>9 Q Does AU 312.07 continue with a</p> <p>10 one-sentence example of what it means by the</p> <p>11 second sentence that you quoted?</p> <p>12 A Yes.</p> <p>13 Q And what is the example?</p> <p>14 A For example, an illegal payment of an</p> <p>15 otherwise immaterial amount could be material if</p> <p>16 there is a reasonable possibility that it could</p> <p>17 lead to a material contingent liability or a</p> <p>18 material loss of revenue.</p> <p>19 Q Why did you leave that example out of</p> <p>20 your Paragraph 5?</p> <p>21 A I think the first sentence sets the pace,</p> <p>22 sets the standard, this is one example. There is</p> <p>23 lots of examples.</p> <p>24 When you write a report like this, you</p>	<p>Page 218</p> <p>1 discussed previously today, really lays out all of</p> <p>2 the various pieces of GAAP and its hierarchy.</p> <p>3 Q Now, in Item C on page 8, Item C on</p> <p>4 page 8, you say, "For entities such as AHERF and</p> <p>5 its obligated groups which issued municipal</p> <p>6 securities, rules and interpretive releases of the</p> <p>7 SEC have the highest authority similar to Category</p> <p>8 1." Do you see that?</p> <p>9 A I do.</p> <p>10 Q Are staff accounting bulletins</p> <p>11 interpretive releases of the SEC or rules of the</p> <p>12 SEC?</p> <p>13 A Did you finish?</p> <p>14 Q Yes.</p> <p>15 THE WITNESS: Can I hear the question?</p> <p>16 (Question read)</p> <p>17 A I look at them as practices followed by</p> <p>18 the SEC staff in administering SEC disclosures, so</p> <p>19 they don't -- I don't view them as part of</p> <p>20 Category 1.</p> <p>21 BY MR. ROSENTHAL:</p> <p>22 Q Is it possible that a non-professional</p> <p>23 and non-technically informed reader of your</p> <p>24 Paragraph C could get the impression that you</p>